Supreme Court, U.S.
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IN THE

Supreme Court of the United States

WILLIAM K. HOLMES, HOLMES CAPITAL, LLC, BREW DOG, LLC, BIMINI STAR, LLC, and EBH INVESTMENTS CO., LLC,

Petitioners,

-v.-

JACK GRUBMAN and CITIGROUP GLOBAL MARKETS, INC. F/K/A SALOMON SMITH BARNEY& CO., INC.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The Second Circuit affirmed the district court's judgments dismissing William K. Holmes, Holmes Capital, LLC, Brew Dog, LLC, Bimini Star, LLC and EBH Investments Co., LLC's (collectively "Mr. Holmes") state law claims for breach of fiduciary duty, negligent misrepresentation and fraud against their stockbroker by determining that Mr. Holmes did not meet the pleading standard for loss causation, an element of a claim under the Private Securities Litigation Reform Act ("PSLRA") § 101(b), 15 U.S.C. § 78u-4(b)(4), established by this Court in *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336 (2005). Mr. Holmes' claims were dismissed, notwithstanding that the claims (a) are not class action claims; (b) are not federal securities fraud claims; (c) allege misrepresentations made directly to Mr. Holmes; (d) allege specific direct reliance, not presumed reliance under the fraud-on-the-market theory; and (e) allege self dealing and conflict of interest by Mr. Holmes' stockbroker. The Second Circuit's decision ignores the narrow focus of *Dura*, *supra;* defeats this Court's stated view that the federal securities fraud statutes are not intended to supplant common-law claims; and is inconsistent with the holdings of *Schaaf v. Residential Funding Corp.*, 517 F.3d 544, 550 (8th Cir 2007); *New York City Employees' Retirement System*, 593 F.3d 1018, 1024 (9th Cir.); *Merrill Lynch & Co. Inc. v. Allegheny Energy, Inc.*, 500 F.3d 171 (2nd Cir. 2007); *Livid Holdings LTD v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 949 (9th Cir 2005).

Two questions are presented:

1. Does the pleading standard established by *Dura*, *supra*, for the element of loss causation for a claim under the Private Securities Litigation Reform Act ("PSLRA") § 101(b), 15 U.S.C. § 78u-4(b)(4), apply to a plaintiff's claim for breach of fiduciary duty against its stockbroker if the claim involves publicly traded securities?

2. Does the pleading standard established by *Dura*, *supra*, for the element of loss causation for a claim under the Private Securities Litigation Reform Act ("PSLRA") § 101(b), 15 U.S.C. § 78u-4(b)(4), apply to a plaintiff's claim for fraud or negligent misrepresentation against its stockbroker, where a direct misrepresentation is alleged to have been made to the plaintiff, direct reliance on the misrepresentation is alleged, and publicly traded securities are involved?

LIST OF PARTIES

The parties below are listed in the caption. In addition, the Public Investors Arbitration Bar Association and the National Association of Shareholder and Consumer Attorneys appeared as *amicus curiae* in support of Petitioners before the Georgia Supreme Court for its consideration of the questions certified to it by the United States Court of Appeals for the Second Circuit and The Securities Industry and Financial Markets Association appeared as *amicus curiae* in support of Respondents before the Georgia Supreme Court for its consideration of the questions certified to it by the United States Court of Appeals for the Second Circuit.

CORPORATE DISCLOSURE STATEMENT

Holmes Capital, LLC is a Georgia limited liability company. It has no parent corporation. It issues no stock. No publicly held company has any ownership interest in Holmes Capital, LLC.

Brew Dog, LLC is a Georgia limited liability company. It has no parent corporation. It issues no stock. No publicly held company has any ownership interest in Brew Dog, LLC.

Bimini Star, LLC is a Georgia limited liability company. It has no parent corporation. It issues no stock. No publicly held company has any ownership interest in Bimini Star, LLC.

EBH Investments Co., LLC is a Georgia limited liability company. It has no parent corporation. It issues no stock. No publicly held company has any ownership interest in EBH Investments Co., LLC.

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OPINION BELOW

The initial opinion of the United States Court of Appeals for the Second Circuit which certified questions to the Supreme Court of Georgia is reported at *Holmes v. Grubman*, 568 F.3d 329 (C.A.2 2009). The Opinion of the Supreme Court of Georgia answering the questions certified to it by the United States Court of Appeals for the Second Circuit is reported at *Holmes v. Grubman*, 691 S.E.2d 196 (S. Ct. Ga. 2010). The Summary Order of the United States Court of Appeals affirming the decisions of the United States District Court for the Southern District of New York, one of which is reported at 456 F. Supp. 2d (S.D.N.Y. 2006) the other of which is not reported, but can be found at 2006WL751382(S.D.N.Y. March 24, 2006)(No. 02Civ3288 (DLC), 04 Civ. 8308), is not reported, but can be found at 2010 WL 2540752 (C.A.2 N.Y.) June 23, 2010 (No. 06-5246-C). *See* Appendices A-E.

STATEMENT OF JURISDICTION

This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

The Second Circuit's Summary Order was entered on June 23, 2010.

STATUTORY PROVISIONS INVOLVED

Title 15 United States Code, Section 78u-4(b)

(b) Requirements for securities fraud actions

(1) Misleading statements and omissions

In any private action arising under this chapter in which the plaintiff alleges that the defendant—

(A) made an untrue statement of a material fact; or

(B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;

the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

(2) Required state of mind

In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to

each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

(3) Motion to dismiss; stay of discovery

(A) Dismissal for failure to meet pleading requirements

In any private action arising under this chapter, the court shall, on the motion of any defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met.

(B) Stay of discovery

In any private action arising under this chapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.

(C) Preservation of evidence

(i) In general

During the pendency of any stay of discovery pursuant to this paragraph, unless otherwise ordered by the court, any party to the action with actual notice of the allegations contained

in the complaint shall treat all documents, data compilations (including electronically recorded or stored data), and tangible objects that are in the custody or control of such person and that are relevant to the allegations, as if they were the subject of a continuing request for production of documents from an opposing party under the Federal Rules of Civil Procedure.

(ii) Sanction for willful violation

A party aggrieved by the willful failure of an opposing party to comply with clause (i) may apply to the court for an order awarding appropriate sanctions.

(D) Circumvention of stay of discovery

Upon a proper showing, a court may stay discovery proceedings in any private action in a State court, as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this paragraph.

(4) Loss causation

In any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages.

STATEMENT OF THE CASE

As of June 1999, Mr. Holmes, along with the other Petitioners through which he invested (collectively referred to herein as "Mr. Holmes"), owned approximately 2.1 million shares of WorldCom securities. Throughout the time period in which Worldcom stock was acquired and held, Mr. Holmes relied on his stockbroker Salomon Smith Barney n/k/a Citigroup Global Markets, Inc. ("SSB"), one of the Respondents herein. Mr. Holmes relied specifically on communications with his financial advisor employed by SSB, Mr. Charles Parker, in the management of the stock. Mr. Parker routinely reviewed with Mr. Holmes SSB's research reports, created by its financial analyst Jack Grubman, Respondent herein, and discussed with Mr. Holmes the weekly conference calls in which Mr. Parker participated concerning the investment quality of WorldCom stock.

SSB's research was presented to Mr. Holmes by Mr. Parker as being objective and independent. In truth and in fact, SSB provided positive coverage for WorldCom, regardless of the stock's true value, for the purpose of generating revenue for SSB's investment banking department. Because Mr. Grubman's compensation was calculated based on his contributions to investment banking, he had no objectivity or independence in his coverage of WorldCom. SSB was also able to secure WorldCom's lucrative investment banking business through its practice of allocating "hot" initial public offering (IPO) stock to Bernie Ebbers, the CEO of WorldCom. SSB gave Mr. Ebbers millions of dollars of "free money" in "hot" IPO shares so that Mr. Ebbers would continue to bring SSB hundreds of millions of dollars in investment banking business.

On June 25, 1999, Mr. Holmes decided to liquidate all of Petitioners' holdings in WorldCom and placed a verbal sell order with Mr. Parker for all of their respective shares of WorldCom stock. At that time, the stock was selling for $92 per share and SSB had recently updated its target price for the stock to $130 per share. Mr. Parker did not execute the sell order, but rather dissuaded Mr. Holmes from consummating the transaction based on SSB's target price, research, public representations and his participation in weekly internal conference calls regarding WorldCom, touting Mr. Grubman's reputation and analyst reports. Mr. Holmes was unaware of SSB's conflicts of interest and Mr. Grubman's failure to use principled methodology in setting target prices and providing allegedly "independent" analyst information when Mr. Holmes was dissuaded from selling all 2.1 million WorldCom shares on June 25, 1999. Had he known that the investment quality of the WorldCom stock was not as directly represented to him by Mr. Parker, on June 25, 1999, he would have sold all of his holdings. Moreover, he would not have acquired additional shares after that date. SSB's obvious conflict of interest compromised its fiduciary obligations to Mr. Holmes with respect to the order to sell on June 25, 1999, and its subsequent encouragement of Mr. Holmes to buy more WorldCom stock. Mr. Holmes holdings in the WorldCom stock were ultimately sold by SSB to satisfy margin calls on margin accounts SSB had encouraged Mr. Holmes to open rather than liquidating stock.

Petitioners originally filed their Complaint for common law fraud, negligent misrepresentation, and breach of fiduciary duty, along with certain other claims,

with the United States Bankruptcy Court for the Middle District of Georgia on June 24, 2003, amending the same on July 14, 2003. On February 18, 2004, Respondents filed a Motion for Withdrawal of the Reference, which was conditionally granted by the United States District Court for the Middle District of Georgia on April 29, 2004. Jurisdiction in the Georgia district court was proper pursuant to 28 U.S.C. § 1332 as diversity of citizenship exists between Petitioners and Respondents. On October 15, 2004, pursuant to 28 U.S.C. § 1407, the Judicial Panel on Multi-District Litigation transferred this matter to the United States District Court for the Southern District of New York to be consolidated with all individual actions and the Class Action involving common questions of law and fact related to the bankruptcy of WorldCom, Inc. *See In re WorldCom, Inc. Sec. Litig.*, 2002 WL 31867720 (S.D.N.Y. Dec 23, 2002).

On March 24, 2006, the United States District Court for the Southern District of New York ("district court") entered an order dismissing all claims brought by Petitioners against Respondents with leave to amend and re-file certain of those claims ("March Order"). Petitioners subsequently filed their Third Amended Complaint ("TAC"). On October 13, 2006, the district court entered an order dismissing all of Petitioners' claims in the TAC ("October Order").

Petitioners filed their Notice of Appeal on November 13, 2006. The Second Circuit issued an opinion on June 3, 2009, certifying three questions to the Supreme Court of Georgia. The Supreme Court of Georgia answered the questions certified to it on February 8, 2010. Petitioners timely filed a Motion for Reconsideration

with the Supreme Court of Georgia on February 18, 2010, which was denied on March 15, 2010. The Second Circuit, by Summary Order entered June 23, 2010, summarily affirmed the district court's opinions.

REASONS FOR GRANTING THE PETITION

Whether the federal securities fraud statutes, specifically 15 U.S.C. § 78-u4(b), and the United States Supreme Court Case, *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336 (2005), interpreting the same should apply to common law torts of fraud, negligent misrepresentation and breach of fiduciary duty concerning publicly traded securities is an important question, implicating the federal government's unauthorized preemption of state law claims, on which this Court's guidance is urgently warranted. The Second Circuit's Order effectively bars breach of fiduciary duty claims brought by investors against their own stockbrokers and limits the way in which parties can plead and prove proximate cause in fraud and negligent misrepresentation claims. This result is in conflict with both *Dura* and numerous other opinions of this Court interpreting and applying federal securities fraud statutes.

I. Review is Warranted to Prevent the Improper Application of Federal Securities Fraud Statutes on Common Law Fraud and Negligent Misrepresentation Claims by Both Federal and State Courts.

In an effort to protect the integrity and efficient operation of the market for nationally traded securities, Congress enacted the Securities Act of 1933 (1933 Act, 48 Stat. 74, and the Securities Exchange Act of 1934 (134 Act), 48 stat. 881. *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006). While neither Act provides for a private right of action, one has been implied. *Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971). As a consequence of perceived abuses of class action lawsuits brought under the Acts, Congress, in 1995, enacted the Private Securities Litigation Reform act of 1995 ("PSLRA"), 15 U.S.C. §§ 77z-1 and 78u-4. *Dabit, supra* at 81. These federal securities fraud statutes, and in particular the PSLRA, however, were not intended to prevent individual plaintiffs from pursuing state law claims for wrongs suffered by them involving publicly traded securities. This Court in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005) differentiates the federal statutes and regulatory rules from common-law tort actions for deceit and misrepresentation stating that they resemble, but are not identical to each other, citing its prior opinions in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730, 744 (1975) and *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976). *Id.* at 341 and 343. *See also Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, (2008) ("Though §10(b) is 'not limited to preserving the integrity of the

securities markets, [], it does not reach all commercial transactions that are fraudulent and affect the price of a security in some attenuated way. . . . Section 10(b) does not incorporate common-law fraud into federal law."); *SEC v. Zandford*, 535 U.S. 813, 820 (2002) ("Section 10(b) must not be construed so broadly as to convert every common-law fraud that happens to involve securities into a violation"); *Marine Bank v. Weaver*, 455 U.S. 551 (1982) ("Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud"). This Court has made clear that remedies beyond those afforded by a private cause of action under the federal securities laws are available to individual plaintiffs at common law.

This Court in *Dura* was unequivocal about the narrow nature of its opinion. The ultimate holding in Section A of the opinion provides:

> In sum, we find the Ninth Circuit's approach inconsistent with the law's requirement that a plaintiff prove that the defendant's misrepresentation (or other fraudulent conduct) proximately caused the plaintiff's economic loss. We need not, and do not, consider other proximate cause or loss-related questions.

Dura, supra at 346. Additionally, this Court went to great lengths to specify both the context and purpose of its holding. Justice Breyer begins the opinion by establishing that the claim under review is a securities fraud claim brought pursuant to 15 U.S.C. § 78u-4(b)(4) and its implementing regulations 17 CFR § 240.10b-5

(2004). *Id.* at 338 and 341. The issue before it was as follows: "We consider a Ninth Circuit holding that a plaintiff can satisfy this requirement [proving that the defendant's fraud caused an economic loss] – a requirement that courts call 'loss causation'- simply by alleging in the complaint and subsequently establishing that 'the price' of the security '*on the date of purchase* was inflated because of the misrepresentation.'" *Id.* at 338, *quoting* the Ninth Circuit's opinion under review at 339 F.3d 933, 938 (9th Cir. 2003).

The standard of causation enunciated by the Ninth Circuit was inconsistent with the law of all other federal circuit courts on the issue. The complaint at issue stated "the following (and nothing significantly more than the following) about economic losses attributable to the spray device misstatement: '*In reliance on the integrity of the market, [the plaintiffs] ... paid artificially inflated prices for Dura securities' and the plaintiffs suffered 'damage[s]' thereby.*'" *Id.*

The Second Circuit's affirmance of the dismissal of Mr. Holmes' fraud and negligent misrepresentation claims based on the Supreme Court of Georgia's answer to the question certified to it regarding proximate cause ignores both the narrow application of the *Dura* holding and the gap that common law fraud and negligent misrepresentation claims are intended to fill for those damages not recoverable under the federal securities statutes.

II. Review is Warranted to Make Clear that *Dura* Does Not Establish Any Standard for Breach of Fiduciary Duty Claims

While the protection of the integrity and efficiency of the market for nationally traded securities is the goal of the federal securities fraud statutes, the interpretation and application of those statutes should not eviscerate the equally important goal of providing remedies to investors whose stockbrokers have placed their own self interest above that of their clients.[1] By applying the *Dura* pleading standard to breach of fiduciary duty claims involving publicly traded securities, the Second Circuit has effectively barred such claims. The Second Circuit's rationale is simply that because proximate cause is an element of breach of fiduciary duty, *Dura* applies. The Circuit Courts have recognized the substantial difference in fraud claims and breach of fiduciary duty claims. The Seventh Circuit in *Harzewski v. Guidant Corp.*, 489 F.3d 799 (7th Cir. 2007) explains that "[t]he burden of proving fraud is heavier than that of proving a breach of fiduciary duty . . . . Such a breach might consist in . . . self-dealing and other conflicts of interest . . . examples of misfeasance rather

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[1] Obtaining a client's trust and confidence, and convincing the client that he or she should rely upon the investment advice given is at the heart of the broker/client relationship. Studies in behavioral finance demonstrate that securities brokers are highly motivate to cultivate their clients' trust and allegiance, and clients have powerful incentives to believe that such advisors are trustworthy and acting solely in the client's best interest. Langevoort, *Selling Hope, Selling Risk: some Lessons for Law from Behavioral Economics about Stockbrokers and Sophisticated Customers*, 84 *Calif. L. Rev.* 627 (May 1996).

than malfeasance, involving no misrepresentations, and in short falling short of fraud." *Id.* at 805. Although the discussion of breach of fiduciary duty in *Harzewski* is in the context of ERISA, its comparison with fraud applies with equal force here. In fact, *Harzewski* compares securities fraud claims under 15 U.S.C. § 78u-4(b) and *Dura* with breach of fiduciary duty claims under 29 U.S.C. § 1104(a).

The necessity for this Court to clarify *Dura* and the PSLRA's inapplicability to breach of fiduciary duty claims is critical so that plaintiffs are assured of a remedy for stockbrokers who place their own self-interest above their clients. A pleading standard based on fraud-on-the-market is contrary to the very nature of a fiduciary relationship which is personal and direct. It cannot be the law that the proximate cause standard for a breach of fiduciary duty claim against a stockbroker requires a public revelation of self-dealing, a conflict of interest, or a private conversation between a broker and client in order to precipitate a fall in the price of stock thereby causing damage. Such could not have been this Court's intent in rendering its decision in *Dura*. As a result of the Second Circuit's misapplication of the *Dura* standard to a breach of fiduciary duty claim it is imperative that the Supreme Court review this issue, and clarify the breadth and scope of *Dura*.

III. Review is Necessary to Resolve Existing Conflicts in the Interpretation and Application of the *Dura* Pleading Standard

The Second Circuit's Summary Order applying the Supreme Court of Georgia's answer to the certified question regarding proximate cause is in conflict with other Circuit and State Appellate Court's regarding the interpretation and application of the *Dura* pleading standard. In fact, only one Circuit Court has embraced the interpretation and application of *Dura* reflected in the Supreme Court of Georgia's opinion. The Fourth Circuit in *Glaser v. Enzo Biochem, Inc.*, 464 F.3d 474 (4th Cir. 2006) held that, as to the common law fraud claim, "*Dura* requires plaintiffs to plead loss causation by alleging that the stock price fell after the truth of a misrepresentation about the stocks was revealed . . .." *Id.* at 477. The Georgia Supreme Court, in large part, based its decision on the *Glaser* opinion.[2] Other Circuits, however, have not so held and have made clear that causation can be established by means other than that articulated in *Dura*. *See Schaaf v. Residential Funding Corp.* , 517 F.3d 544, 550 (8th Cir 2007)(causation can be proven by showing that loss was foreseeable and that the loss was caused by a materialization of the concealed risk); *New York City Employees' Retirement System*, 593 F.3d 1018, 1024 (9th Cir.) (*Dura* does not establish the exclusive method of showing loss causation); *Merrill*

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[2] In reaching its decision on the certified question regarding proximate cause, the Georgia Supreme Court also erroneously relied on *In re Williams Securities Litigation-WCG Subclass*, 558 F.3d 1130 (10th Cir. 2009) which is a class action, federal securities fraud case, involving the presumption of reliance through the fraud-on-the-market theory.

Lynch & Co. Inc. v. Allegheny Energy, Inc., 500 F.3d 171 (2nd Cir. 2007)(*Dura's* conclusion is based on the tailored application set out by the Supreme Court in the securities context); *Livid Holdings LTD v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 949 (9th Cir 2005)(*Dura* did not consider other proximate cause or loss-related questions other than loss causation in the context of fraud-on-the-market cases involving publicly traded stock); *Lopez v. Rica Foods, Inc.*, 277 Fed. Appx. 931, 932 (11th Cir. 2008)(Although not reported in the Federal Reporter, *Lopez* is instructive in discerning the limitation of *Dura*)("The district court erred by requiring Plaintiffs to plead *Dura Pharm's* loss causation analysis because Count IV-VII of the SAC do not allege securities fraud, i.e., these claims do not 'arise under' the Securities Exchange Act of 1934. Rather, these counts allege basic common law fraud.")

The one state appellate court opinion analyzing the *Dura* standard is at odds with the Second Circuit's Order. The Court of Appeals of Arizona in *Grand v. Nacchio*, 147 P.3d 763 (CA Ariz. 2006)[3] discerned and distinguished the narrow focus of the *Dura* opinion,

> [Respondent] relies on the [Supreme Court's reference to comment b to § 548A of the Restatement (Second) of Torts (1977)] to argue the holding in *Dura* means "a misrepresentation causes a loss only if that

[3] *Grand* was noted by the Georgia Supreme Court at page 12 of its Opinion for the proposition that *Dura* provides that proximate cause must be shown in any securities fraud case, statutory or common law.

> loss reflects a drop in the price of the securities that directly results from the revelation of the truth behind the misrepresentation." We disagree; *Dura* creates no such rule. The Supreme Court referred to the Restatement to illustrate that the Ninth Circuit's " 'inflated purchase price' approach" was inconsistent with "the judicial consensus" on proximate cause, 544 U.S. at 344, 125 S.Ct. at 1632-33, and to clarify that implied private actions for securities fraud resemble common law misrepresentation actions and thus require a showing of proximate cause, *id.* at 343, 125 S.Ct. at 1632. The Court did not suggest it was describing the exclusive means by which a plaintiff can establish proximate cause.

Grand at 774.

The appeals court in *Grand* goes on to quote an illustration for comment b of the Restatement (Second) of Torts § 548A to make clear that the section quoted by the Court in *Dura* does not describe an exclusive method of proving causation. "*Dura* does not significantly restrict the means by which a plaintiff can show proximate cause; it only clarifies that merely alleging an inflated purchase price is insufficient to do so." *Grand* at 782. "[A]lthough demonstrating that the price of a security dropped following the disclosure of some misrepresentation is one method of proving loss

causation, nothing in Dura makes it the exclusive method." *Grand* at 774-775 (emphasis supplied).[4]

The importance of Supreme Court resolution of the myriad of interpretations and applications of the *Dura* standard is not limited to this case. States have a strong interest in maintaining integrity in the marketplace and rebuilding investor confidence, particularly in light of major corporate scandals and ponzi schemes that have been revealed in recent years and that have depleted the life savings of millions of investors. The Second Circuit's imposition of the pleading standards for proximate cause established under the PLSRA (loss causation) on common law fraud and negligent misrepresentation claims are at odds with common law jurisprudence which does not contemplate class actions or presumed reliance. If any state, including Georgia, determines that a more rigorous proximate cause pleading requirement is needed only for fraud and negligent misrepresentation claims involving publicly traded securities, it is for the legislature of the respective state to set forth those requirements, not the judiciary. To that end, it is imperative that the Supreme Court review the Second Circuit's Order to insure that "judicial legislation" does not occur.

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[4] "[S]everal legal commentators have concluded the *Dura* ruling does not preclude other methods of proving loss causation. *See* Madge S. Thorsen et al., *Rediscovering the Economics of Loss Causation*, 6 J. Bus. & Sec. L. 93, 118 (2006) ('The Court did not say (or even imply) that 'truth then price drop' was to become the only test of loss causation ....'); Merrit B. Fox, *Understanding Dura*, 60 Bus. Law. 1547, 1552 (2005) ('The Court's holding in *Dura* is extremely narrow . . . [and] does not specify what kinds of allegations and proof would be sufficient to [show loss causation].')" *Grand* at 775.

CONCLUSION

For all the foregoing reasons, Petitioners respectfully request that the Supreme Court grant review of this matter.

Respectfully submitted,

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APPENDIX

APPENDIX A — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DATED JUNE 23, 2010

SUMMARY ORDER

WILLIAM K. HOLMES, HOLMES CAPITAL, LLC, BREW DOG, LLC, BIMINI STAR, LLC, and EBH INVESTMENTS CO., LLC,

Plaintiffs-Appellants,

v.

JACK GRUBMAN and CITIGROUP GLOBAL MARKETS INC. f/k/a Smith Barney Co., Inc.,

Defendants-Appellees.

PRESENT:

JOHN M. WALKER, JR.,
JOSE A. CABRANES,
Circuit Judges.*

UPON CONSIDERATION WHEREOF, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment of the District Court is **AFFIRMED.**

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* Judge Reena Raggi recused herself from participating in oral argument and deciding this appeal. The appeal has been decided by the remaining two members of the panel, who are in agreement. See 2d Cir. Local Rules, Internal Operating Procedure E(b).

Appendix A

This case returns to us from the Supreme Court of Georgia to which we had certified questions of state law. *See Holmes v. Grubman*, 568 F.3d 329 (2d Cir. 2009). We certified the following three questions:

> I. Does Georgia common law recognize fraud claims based on forbearance in the sale of publicly traded securities?
>
> II. With respect to a tort claim based on misrepresentations or omissions concerning publicly traded securities, is proximate cause adequately pleaded under Georgia law when a plaintiff alleges that his injury was a reasonably foreseeable result of defendant's false or misleading statements but does not allege that the truth concealed by the defendant entered the marketplace, thereby precipitating a drop in the price of the security?
>
> III. Under Georgia law, does a brokerage firm owe a fiduciary duty to the holder of a non-discretionary account?

Id. at 340-41.

The Supreme Court of Georgia has answered those questions in an opinion: *Holmes v. Grubman*, 286 Ga. 636, 691 S.E.2d 196, 2010 WL 424225 (Ga. 2010). In doing so it agreed with the District Court's interpretation of Georgia law on proximate cause, holding that proximate cause requires "that the truth concealed by the

defendant entered the marketplace, thereby precipitating a drop in the price of the security." 286 Ga. 636, 691 S.E.2d 196, Id. at * 6. On the remaining certified questions, the Supreme Court of Georgia held that Georgia common law recognizes fraud claims based on forbearance in the sale of publicly traded securities (so-called "holder" claims) and that Georgia law recognizes a fiduciary duty owed by a brokerage firm to the holder of a non-discretionary account. 286 Ga. 636, 691 S.E.2d 196, Id. at *3-4, *6. Both of those holdings run contrary to the District Court's rulings below. *See Holmes v. Grubman*, Nos. 02 Civ. 3288, 04 Civ. 8308, 2006 U.S. Dist. LEXIS 12471, 2006 WL 751382, at *2 (S.D.N.Y. Mar. 24, 2006) (holding that Georgia law does not recognize "holder" claims); *Holmes v. Grubman*, 456 F. Supp. 2d 508, 517 (S.D.N.Y. 2006) (holding that a brokerage firm owes no fiduciary duty to holders of non-discretionary accounts under Georgia law).

Although the District Court did not accurately anticipate the Supreme Court of Georgia's rulings with respect to two of the certified questions, we nevertheless conclude that plaintiffs' claims properly were dismissed. Proximate cause is an element of claims of fraud, negligence, and breach of fiduciary duty under Georgia law. *See Taylor v. Bennett Chevrolet/Buick, Inc.*, 271 Ga. App. 300, 609 S.E.2d 215, 217 (Ga. Ct. App. 2005) (fraud); *Cieplinski v. Caldwell Elec. Contractors, Inc.*, 280 Ga. App. 267, 633 S.E.2d 646, 650 (Ga. Ct. App. 2006) (negligence); *Newitt v. First Union Nat'l Bank*, 270 Ga. App. 538, 607 S.E.2d 188, 196 (Ga. Ct. App. 2004) (negligent misrepresentation); *Savu v. SunTrust Bank*,

293 Ga. App. 683, 668 S.E.2d 276, 283 n.16 (Ga. Ct. App. 2008) (breach of fiduciary duty). The District Court dismissed plaintiffs' claims of fraud, negligence, and negligent misrepresentation because plaintiffs failed to plead adequately proximate cause, and the Supreme Court of Georgia confirmed that, in doing so, the District Court applied the correct legal standard. Accordingly, we affirm the District Court's dismissal of plaintiffs' claims of fraud (including plaintiffs' "holder" claims), negligence, and negligent misrepresentation substantially for the reasons stated in the District Court's careful Opinion and Order. *See Holmes*, 456 F. Supp. 2d at 514-17.

Although the District Court did not rely on a lack of proximate cause in dismissing plaintiffs' claim for breach of fiduciary duty, we may affirm the judgment of the District Court on any basis supported by the record, including grounds upon which the District Court did not rely. *See Prisco v. A & D Carting Corp.*, 168 F.3d 593, 610 (2d Cir. 1999). *Because proximate* cause is an element of a claim for breach of fiduciary duty, we conclude that dismissal of that claim was also warranted.

CONCLUSION

We have considered all of plaintiffs' arguments and find them to be without merit. For the foregoing reasons, the judgment of the District Court is **AFFIRMED.**

FOR THE COURT,
Catherine O'Hagan Wolfe, Clerk of Court

APPENDIX B — DECISION OF THE SUPREME COURT OF GEORGIA DATED FEBRUARY 8, 2010

Decided: February 8, 2010

S09Q1585. HOLMES et al. v. GRUBMAN et al.

CARLEY, Presiding Justice.

As of June 1999, Appellants William K. Holmes and four entities controlled by him owned 2.1 million shares in WorldCom, Inc., the major telecommunications company which went bankrupt after the revelation of massive accounting fraud in 2002. In this suit against Appellees Citigroup Global Markets, Inc., f/k/a Salomon Smith Barney & Co., Inc. (SSB), and its financial analyst, Jack Grubman, Appellants allege that, on June 25, 1999, Holmes verbally ordered his broker at SSB to sell all of Appellants' WorldCom stock, which was then being traded at approximately $92 per share. Appellants further allege that the SSB broker convinced Holmes not to sell, based on recent research reports by Grubman and on his reputation, and that Appellees were operating under a conflict of interest, knowing that WorldCom stock was grossly overvalued, but nevertheless promoting it in order to retain WorldCom's lucrative investment banking business. Instead of selling, Holmes purchased additional shares as the stock price declined. In October 2000, Appellants were forced to sell all of their WorldCom shares in order to meet margin calls, resulting in alleged losses of nearly $200 million.

Appendix B

Appellants filed for bankruptcy and, in 2003, brought this action for damages under Georgia law in the United States Bankruptcy Court for the Middle District of Georgia. The case was transferred to the United States District Court for the Southern District of New York and consolidated for pre-trial purposes with the multi-district WorldCom Securities Litigation. Appellants' third amended complaint includes claims of fraud, negligent misrepresentation, negligence in making disclosures, and breach of fiduciary duty. The district court dismissed that complaint for failure to state a claim upon which relief can be granted. *Holmes v. Grubman (In re WorldCom, Inc. Securities Litigation)*, 456 F.Supp.2d 508 (S.D.N.Y. 2006). On appeal, the United States Court of Appeals for the Second Circuit certified the following three questions to this court:

> (1) Does Georgia common law recognize fraud claims based on forbearance in the sale of publicly traded securities?
>
> (2) With respect to a tort claim based on misrepresentations or omissions concerning publicly traded securities, is proximate cause adequately pleaded under Georgia law when a plaintiff alleges that his injury was a reasonably foreseeable result of defendant's false or misleading statements but does not allege that the truth concealed by the defendant entered the market place, thereby precipitating a drop in the price of the security?

> (3) Under Georgia law, does a brokerage firm owe a fiduciary duty to the holder of a non-discretionary account?

Holmes v. Grubman, 568 F3d 329, 340-341 (D) (2nd Cir. 2009).

1. The claims to which the first question refers are often called "holder" claims. Although this Court has never specifically addressed such claims, it is well-settled that one of the elements of the tort of fraud in Georgia is an "'intention to induce the plaintiff to act *or refrain from acting* . . . .' [Cit.]" (Emphasis supplied.) *Stiefel v. Schick*, 260 Ga. 638, 639 (1) (398 SE2d 194) (1990). See also Charles R. Adams III, *Ga. Law of Torts* § 32-1, p. 659 (2008-2009 ed.). This language is consistent with the Restatement (Second) of Torts § 525 (1977) and the general rule that "induced forbearance can be the basis for tort liability. ([Cits.])" *Small v. Fritz Cos.*, 65 P3d 1255, 1259 (II) (Cal. 2003). See also *Rogers v. Cisco Systems*, 268 FSupp.2d 1305, 1313 (II) (B) (2) (N.D. Fla. 2003); *Gutman v. Howard Savings Bank*, 748 FSupp. 254, 262 (II) (B) (1), 264 (II) (B) (2) (D.N.J. 1990).

> The public policy underlying the actionability of fraud exists regardless of whether plaintiff is induced to act or refrain from action. Lies which deceive and injure do not become innocent merely because the deceived continue to do something rather than begin to do something else. Inducement is the substance of reliance; the form of reliance-

action or inaction-is not critical to the actionability of fraud.

Gutman v. Howard Savings Bank, supra at 264 (II) (B) (2).

The Supreme Court of the United States has held that only actual purchasers or sellers of securities can make a claim pursuant to Rule 10b-5, promulgated by the Securities and Exchange Commission under § 10 (b) of the Securities Exchange Act of 1934. *Blue Chip Stamps v. Manor Drug Stores*, 421 U. S. 723,730-731 (II), 749 (III)(95 SC 1917,44 LE2d 539)(1975). However, that Court also noted that one disadvantage of its holding "is attenuated to the extent that remedies are available to nonpurchasers and nonsellers under state law. [Cits.]" *Blue Chip Stamps v. Manor Drug Stores*, supra at 738 (III) fn. 9. Indeed, the Supreme Court recognized that it has "long been established in the ordinary case of deceit that a misrepresentation which leads to a refusal to purchase or to sell is actionable in just the same way as a misrepresentation which leads to the consummation of a purchase or sale. [Cit.]" *Blue Chip Stamps v. Manor Drug Stores*, supra at 744 (III). Compare *Merrill Lynch, Pierce, Fenner & Smith v. Dabit*, 547 U. S. 71, 87 (IV) (126 SC 1503, 164 LE2d 179) (2006) (Securities Litigation Uniform Standards Act preempts state-law holder class-action claims).

Furthermore, although Appellees "are immune from 10b-5 liability, they should not be immnunized from common law liability merely because their alleged fraud

occurred in the securities market rather than the real estate or used car market." *Gutman v. Howard Savings Bank*, supra at 266 (II) (B) (2). The Georgia Court of Appeals has acknowledged that "evidence of fraud ... includ[es] evidence which supported the conclusion that [the plaintiffs] were fraudulently induced into making *and keeping* their investments." (Emphasis supplied.) *Argentum Intl. v. Woods*, 280 Ga. App. 440, 445 (2) (b) (634 SE2d 195) (2006). Compare *Mack v. Smith*, 178 Ga. App. 652, 653 (4) (344 SE2d 474) (1986) (where plaintiff's lack of purchase of the securities or investments contracts offered to him by defendants deprived him of standing under federal and state securities statutes, but was not the basis for affirmance of the dismissal of his common-law fraud claim). "Most other states that have confronted this issue have concluded that forbearance from selling stock is sufficient reliance to support a cause of action. ([Cits.])" *Small v. Fritz Cos.*, supra. "Fraud, accompanied by damage to the party defrauded, always gives a right of action to the injured party." OCGA § 51-6-1. Exceptions to this principle of liability "'are not to be lightly created . . . .'" *Small v. Fritz Cos.*, supra at 1265 (II) (C).

Appellees offer several policy grounds for barring holder claims, including, as the Second Circuit noted, "(1) incoherent theories of proximate cause and damages, (2) speculative damages, and (3) unprovable claims of a subjective intent to sell." *Holmes v.*

Grubman, supra at 337 (C) (1). After reviewing all such policy considerations, we conclude that, although they

> may justify placing limitations on a holder's cause of action, they do not justify a categorical denial of that cause of action. . . . [T]he high court's decision in *Blue Chip Stamps*, while recognizing policy considerations similar to those defendants advance here, did not view those considerations as justification for a total denial of relief to defrauded holders; it reasoned only that the *federal* courts could deny a forum to wronged stockholders who are not sellers or buyers without unjust consequences because these stockholders retained a remedy in *state* courts. (Emphasis in original.)

Small v. Fritz Cos., supra at 1260 (II), 1261 (II) (A). "Persons claiming that, for reasons of policy, they should be immune from liability for intentional fraud bear a very heavy burden of persuasion, one that defendants here have not sustained." *Small v. Fritz Cos.*, supra at 1265 (II) (C).

In many of the decisions on which Appellees rely, holder claims were not categorically rejected, but the plaintiffs failed to allege or prove that they specifically desired to sell their stock at a certain time, or causation was not sufficiently alleged or proved. See *Arent v. Distribution Sciences*, 975 F2d 1370, 1374 (3) (8th Cir. 1992); *Kagan v. Edison Bros. Stores*, 907 F2d 690, 692

(7th Cir. 1990); *Crocker v. Fed. Deposit Ins. Corp.*, 826 F2d 347, 350 (II) (B) (5th Cir. 1987); *Arnlund v. Deloitte & Touche*, 199 FSupp.2d 461, 489-490 (C) (1) (E.D.Va. 2002). Similarly, although we have determined that holder claims should be recognized under Georgia law, we further conclude that the limitations imposed in other jurisdictions are appropriate. When acknowledging in *Blue Chip Stamps* the continuing viability of common-law holder claims, "[t]he Supreme Court considered the typical fraud context to be one in which the parties knew each other and the alleged misrepresentations occurred through direct communication." *Gutman v. Howard Savings Bank*, supra at 265 (II) (B) (2). Indeed, the Supreme Court distinguished the "universe of transactions governed by the 1934 Act, [where] privity of dealing or even personal contact between potential defendant and potential plaintiff is the exception and not the rule." *Blue Chip Stamps v. Manor Drug Stores*, supra at 745 (III). Accordingly, we conclude that Georgia law permits holder claims

> where, as here, plaintiffs allege that misrepresentations were directed at them to their injury. Although the price of allowing cases like [Appellees'] to go forward may be that some such cases will unfairly waste the Court's time and the defendants' reputation and money, that is a price the common law has always paid.

Gutman v. Howard Savings Bank, supra at 266 (II) (B) (2). See also *Newby v. Enron Corp. (In re Enron*

Corp. Securities, Derivative & "ERISA" Litigation), 490 FSupp.2d 784, 819 (V) (A) (S.D. Tex. 2007); *Goldin v. Salomon Smith Barney,* 994 S2d 517, 520 (Fla. App. 2008) ("great weight of authority concluding that with holder claims, the direct communication requirement is a logically necessary sub-element of justifiable reliance under New York law. [Cit.]"). We further agree with those courts which require

> specific reliance on the defendants' representations: for example, that if the plaintiff had read a truthful account of the corporation's financial status the plaintiff would have sold the stock, how many shares the plaintiff would have sold, and when the sale would have taken place. The plaintiff must allege actions, as distinguished from unspoken and unrecorded thoughts and decisions, that would indicate that the plaintiff actually relied on the misrepresentations.

Small v. Fritz Cos., supra at 1265 (III). Such distinction

> reinforces the reliance requirement by separating plaintiffs who actually and justifiably relied upon the misrepresentations from the general investing public, who, though they did not so rely, suffered the loss due to the decline in share value. This distinction also separates common law fraud claims, which must prove actual reliance, from federal

securities fraud claims, which may rely upon the fraud-on-the-market theory.

Rogers v. Cisco Systems, supra at 1314 (II) (B) (2), fn. 18.

Although the Second Circuit's first question was limited to fraud claims, the particular phrasing thereof does not prevent us from reformulating or expanding upon the question. *Holmes v. Grubman*, supra at 341 (D). See also *Miller v. Harco Nat. Ins. Co.*, 274 Ga. 387, 389 (552 SE2d 848) (2001). We see no reason why our authorization of common-law fraud claims based on forbearance in the sale of publicly traded securities, along with the limitations articulated above, should not extend to Appellants' other common-law tort claims. In particular, we note that "'(t)he same principles apply to both fraud and negligent misrepresentation cases'" and that"' the only real distinction between negligent misrepresentation and fraud is the absence of the element of knowledge of the falsity of the information disclosed.' [Cit.]" *Mindis Acquisition Corp. v. BDO Seidman*, 253 Ga. App. 360, 367 (4) (559 SE2d 111) (2002), rev'd on other grounds, 276 Ga. 311 (578 SE2d 400) (2003). Thus, we hold that negligent misrepresentation claims, like fraud claims, can be based on forbearance in the sale of publicly traded securities. See *Gutman v. Howard Savings Bank*, supra at 264 (II) (B) (2); *Small v. Fritz Cos.*, supra at 1258 (II). The direct communication and specific reliance limitations on fraud claims by "holders" also apply to negligent misrepresentation claims. See *White v. BDO Seidman*, 249 Ga. App. 668, 670 (1) (549 SE2d 490) (2001) (requiring

actual reliance for a common-law negligent misrepresentation claim and rejecting presumed reliance and fraud-on-the-market theories).

2. Regarding the second question, we initially recognize that this Court is not authorized to determine what allegations are necessary for a pleading to be adequate in a federal diversity action. "'Although state law governs the burden of proving fraud at trial, the procedure for pleading fraud in federal courts in all diversity suits is governed by the special pleading requirements of Federal Rule of Civil Procedure 9 (b).' [Cit.]" *Universal Communication Systems v. Lycos*, 478 F3d 413, 427 (III) (1st Cir. 2007). Thus, we will address only the burden placed on a plaintiff at trial to prove proximate cause with respect to a tort claim based on misrepresentations or omissions concerning publicly traded securities.

Appellants contend that Georgia law has incorporated neither the loss causation standard from securities law nor the negligence concept of proximate causation into the intentional tort of fraud. For several decades, however, we have held that, in order to recover in tort for fraud, the plaintiff must prove that he sustained loss or damage as the proximate result of the alleged misrepresentations. *Bacote v. Wyckoff*, 251 Ga. 862, 865 (1) (310 SE2d 520) (1984); *Higginbottom v. Thiele Kaolin Co.*, 251 Ga. 148, 152 (2) (304 SE2d 365) (1983); *Brown v. Techdata*, 238 Ga. 622, 625 (234 SE2d 787) (1977); *McLendon v. Galloway*, 216 Ga. 261, 263 (2) (116 SE2d 208) (1960). See also *Albany Urology Clinic*

v. Cleveland, 272 Ga. 296, 300 (2), fn. 14 (528 SE2d 777) (2000); *Hardaway Co. v. Parsons, Brinckerhoff, Quade & Douglas*, 267 Ga. 424, 426 (1) (479 SE2d 727) (1997) (negligent misrepresentation).

Once again, precedent of the Supreme Court of the United States is informative. *Blue Chip Stamps* involved an aspect of federal securities law which differed from the common law. However, the Supreme Court recently adopted common law causation requirements:

> Judicially implied private securities fraud actions resemble in many (but not all) respects common-law deceit and misrepresentation actions. [Cits.] . . . And the common law has long insisted that a plaintiff in such a case show not only that had he known the truth he would not have acted but also that he suffered actual economic loss. [Cits.] . . . Indeed, the Restatement [(Second)] of Torts, in setting forth the judicial consensus, says that a person who "misrepresents the financial condition of a corporation in order to sell its stock" becomes liable to a relying purchaser "for the loss" the purchaser sustains "when the facts . . . become generally known" and "as a result" share value "depreciate(s)." § 548A, Comment b, at 107. Treatise writers, too, have emphasized the need to prove proximate causation. [Cit.]

Dura Pharmaceuticals v. Broudo, 544 U. S. 336, 343-344 (II) (A) (125 SC 1627, 161 LE2d 577) (2005). We find

"nothing in the *Dura* court's analysis of the common law loss causation requirements that justifies a different standard for plaintiffs' common law fraud claim under [Georgia] law." *Glaser v. Enzo Biochem*, 464 F3d 474, 479 (II) (C) (4th Cir. 2006). "The reasoning of *Dura* ... is equally applicable to any securities claim, be it statutory or based in the common law, because any such claim for damages requires a showing of proximate cause." *Grand v. Nacchio*, 147 P3d 763, 782 (Ariz. App. 2006).

In answer to the second question, we conclude that, with respect to a tort claim based on misrepresentations or omissions concerning publicly traded securities, a plaintiff at trial has the burden of proving that the truth concealed by the defendant entered the marketplace, thereby precipitating a drop in the price of the security. Having reviewed the already-extensive precedent regarding the parameters of the loss causation standard in *Dura*, we note that, while some courts have held that

> the truth could be revealed by the actual materialization of the concealed risk rather than by a public disclosure that the risk exists, [cit.], any theory of loss causation would still have to identify when the materialization occurred and link it to a corresponding loss.

In re Williams Securities Litigation-WCG Subclass, 558 F3d 1130, 1138 (II) (B) (1) (10th Cir. 2009). "Even if the truth has made its way into the marketplace, *Dura*

requires that a plaintiff show that it was this revelation that caused the loss and not one of the 'tangle of factors' that affect price. [Cit.]" *In re Williams Securities Litigation-WCG Subclass*, supra at 1137 (II) (A).

3. Like a majority of courts, the Georgia Court of Appeals has recognized that a stockbroker and his customer have a fiduciary relationship as principal and agent pursuant to OCGA § 23-2-58:

> A stock broker's duty to account to its customer is fiduciary in nature, so that the broker is obligated to exercise the utmost good faith. [Cit.] "'Requirements of good faith demand that in the principal's interest it is the agent's duty to make known to the principal all material facts which concern the transactions and subject matter of his agency.' (Cit.)" [Cit.]

Minor v. E.F. Hutton & Co., 200 Ga. App. 645, 647 (3) (409 SE2d 262) (1991). See also *E.F. Hutton & Co. v. Weeks*, 166 Ga. App. 443, 445 (1) (304 SE2d 420) (1983). Looking to federal precedent, the Court of Appeals has also determined that a stockbroker has limited fiduciary duties towards a customer who holds a non-discretionary account:

> In considering the extent of a broker's duty to its client, federal cases have drawn a distinction between discretionary and nondiscretionary accounts. In a discretionary

> account, the broker is authorized to carry out transactions on behalf of its client without prior authorization, while in a nondiscretionary account the broker is only authorized to transact business after receiving authorization from the client. [Cits.] With respect to a nondiscretionary account ..., the broker owes a number of duties to the client, including the duty to transact business only after receiving prior authorization from the client and the duty not to misrepresent any fact material to the transaction. [Cits.]

Glisson v. Freeman, 243 Ga. App. 92, 99 (1) (532 SE2d 442) (2000). We approve of this analysis. However, we further conclude that the fiduciary duties owed by a broker to a customer with a non-discretionary account are not restricted to the actual execution of transactions. The broker will generally have a heightened duty, even to the holder of a non-discretionary account, when recommending an investment which the holder has previously rejected or as to which the broker has a conflict of interest. See *Leib v. Merrill Lynch, Pierce, Fenner & Smith*, 461 FSupp. 951, 953 (II)(E.D. Mich. 1978) (cited in *Glisson*); 5 Law Sec. Reg. § 14.15[2] (6th ed.).

Certified questions answered. All the Justices concur.

APPENDIX C — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DECIDED JUNE 3, 2009

Docket No. 06-5246-cv

WILLIAM K. HOLMES, HOLMES CAPITAL, LLC, BREW DOG, LLC, BIMINI STAR, LLC, and EBH INVESTMENTS CO., LLC,

Plaintiffs-Appellants,

v.

JACK GRUBMAN and CITIGROUP GLOBAL MARKETS, INC. f/k/ a SMITH BARNEY CO., INC.,

Defendants-Appellees.

August Term 2008

Argued: April 7, 2008

Decided: June 3, 2009

JUDGES: Before: CABRANES and WALKER, Circuit Judges.*

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* Judge Reena Raggi recused herself from participating in oral argument and deciding this appeal. Pursuant to § 0.14 of this Court's local rules, the appeal has been heard and decided by the remaining two judges on the panel, who constitute a quorum. *See* 2d Cir. Local R. 0.14(b) ("If a judge of a panel of the court shall cease to continue with the consideration of any matter . . . the two remaining judges will determine the matter if they reach agreement and neither requests the designation of a third judge."), *available at* 28 U.S.C. Rules Pamphlet, Pt. I, at 342 (2008).

Appendix C

JOSE A. CABRANES, *Circuit Judge*:

This case, which was filed in U.S. District Court for the Middle District of Georgia but consolidated with the WorldCom Securities Litigation in the U.S. District Court for the Southern District of New York (Denise Cote, *Judge*), presents several issues, four of which encompass questions of Georgia law. Plaintiffs-appellants, William K. Holmes and four entities under his control (collectively, "Holmes" or "plaintiffs"), once held a substantial number of shares in WorldCom, the now-defunct telecommunications giant, and allegedly refrained from selling those shares on the advice of their brokerage firm, defendants-appellees Citigroup Global Markets, Inc. ("CitiGroup"), then Salomon Smith Barney & Co., Inc. ("SSB"), and Jack Grubman, an SSB financial analyst.[1] Holmes's decision, allegedly induced by defendants fraudulent misrepresentations, resulted in the financial demise of Holmes and the entities.

We consider whether the District Court erred in (1) denying plaintiffs' untimely motion to amend their complaint or (2) dismissing plaintiffs' claim under Georgia's "blue sky" law [2] on the grounds that plaintiffs failed to state a claim under the relevant statute.

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1. Although, due to Citigroup's acquisition of SSB, SSB is not a party to this appeal, plaintiffs attribute the alleged wrongdoing solely to SSB and Grubman. We therefore refer to SSB, and not Citigroup, throughout the opinion.

2. "Blue sky" laws refer to state laws regulating the exchange of securities. Most blue sky laws "were enacted long

(Cont'd)

Appendix C

Further, resolution of this appeal requires us to consider whether (3) Georgia courts would recognize plaintiffs' claims of fraud based on defendants' alleged intent to cause plaintiffs to refrain from selling securities, (4) plaintiffs have adequately pleaded proximate cause under Georgia law, and (5) SSB owed plaintiffs a fiduciary duty under Georgia law. We affirm the judgment of the District Court with respect to the first two of these five issues. Because the state's highest court has not directly addressed the remaining issues and because we are unable to predict with certainty how the court would rule on them in the instant case, we certify the final three questions to the Supreme Court of Georgia.

(Cont'd)

before the Securities Act of 1933." *Black's Law Dictionary* 183 (8th ed. 2004) (quoting Louis Loss & Edward M. Cowett, Blue Sky Law 3 (1958)). Professor Lawrence M. Friedman has observed that the Kansas blue sky law, which passed in 1911 and was the nation's first, protected interests other than the "unsuspecting investor." Lawrence M. Friedman, American Law in the 20th Century 163 (2002) (noting, in addition, that "by the early 1930s, every state except Nevada had its own blue sky law"). "The blue sky laws were popular with bankers, especially small bankers; investment bankers were mostly on the other side. There was a certain element of local protectionism: when Kansas people invested their money in stock schemes, the money almost always left Kansas for distant parts." *Id.* There are several explanations for the origin of the term. One is that, in 1911, Wall Street's burgeoning securities trade raised for the Kansas legislature the specter of eastern industrialists descending upon the state in an attempt to sell everything, including the blue sky, to unsuspecting Kansans. Black's Law Dictionary 184 (citing 1 Thomas Lee Hazen, Treatise on the Law of Securities Regulation § 8.1, at 490-92 (3d ed. 1995)).

Appendix C

BACKGROUND

Where, as here, we consider a District Court's dismissal of a complaint pursuant to Federal Rule of Civil Procedure 12(b)(6), we "accept[] all factual allegations in the complaint as true." *Burch v. Pioneer Credit Recovery, Inc.*, 551 F.3d 122, 124 (2d Cir. 2008) (internal quotation marks omitted).

In 1998, plaintiffs owned approximately 2.1 million shares of WorldCom stock. Holmes alleges that on June 25, 1999, he ordered his SSB broker to sell all of his WorldCom stock. At that time, WorldCom stock was trading at approximately $ 92.00 per share. According to Holmes, the broker advised him not to sell the stock and observed that recent research reports by Jack Grubman had taken a favorable view of WorldCom. Holmes believed that the advice given by Grubman in his reports was reliable because, as Holmes put it, Grubman's reputation for excellence in analysis of telecommunications securities imbued him with "quasi-celebrity status" as a "swashbuckling deal broker" who "knew 'everyone who was anyone' in the telecom sector . . . including [WorldCom CEO Bernard] Ebbers." Joint Appendix ("J.A.") at 1848 (3d. Am. Comp. P 153).

Based on the broker's advice and Grubman's reports, Holmes not only refrained from selling the WorldCom stock, but also purchased additional shares as the price per share declined. In October 2000, Holmes was forced to sell his WorldCom stock so that his SSB account would satisfy SSB's minimum balance

requirement. According to Holmes, these "margin call" sales resulted in losses of nearly $ 200 million. The Holmes entities then filed for Chapter 11 bankruptcy in the U.S. Bankruptcy Court for the Middle District of Georgia.

In June 2003, plaintiffs brought the instant action seeking compensatory and punitive damages under Georgia law in the same Bankruptcy Court as an adversary proceeding related to the Chapter 11 bankruptcy proceeding. Shortly thereafter, plaintiffs filed an amended complaint alleging, among other things, that SSB and Grubman made negligent and fraudulent misrepresentations designed to induce them to purchase and to refrain from selling WorldCom securities. The gravamen of this compliant was that defendants operated under a conflict of interest, commencing in April 1998, when SSB began to provide underwriting services to WorldCom at the same time that Grubman made purportedly objective investment recommendations in his reports to investors such as Holmes. Holmes alleged that SSB knew that WorldCom stock was grossly overvalued but nevertheless promoted it to him and other account holders in order to secure WorldCom's investment banking business.

The case was transferred to the U.S. District Court for the Southern District of New York and consolidated, for pre-trial purposes, in the multi-district WorldCom Securities Litigation. *See Holmes v. Grubman (In re WorldCom, Inc. Sec. Litig.)*, No. 02 Civ. 3288, 2006 U.S. Dist. LEXIS 12471, 2006 WL 751382, at *1 (S.D.N.Y.

Mar. 24, 2006) ("*Holmes I*" or "March 2006 Opinion"). After the transfer, Holmes filed a second amended complaint and defendants moved to dismiss. On March 24, 2006, the District Court granted defendants' motion on the grounds that (1) under Georgia tort law, plaintiffs cannot recover damages arising from their decision to hold securities instead of selling them, 2006 U.S. Dist. LEXIS 12471, [WL] at *2; (2) plaintiffs failed to identify the statutory provision giving rise to their securities claim under Georgia's securities laws, 2006 U.S. Dist. LEXIS 12471, [WL] at *3; and (3) plaintiffs failed to plead adequately their breach of contract claim, *id.* The District Court, *sua sponte*, permitted plaintiffs to file a third amended complaint, with the following instructions:

> To the extent [plaintiffs] wish to pursue a claim under Georgia's [blue sky law], they must identify the specific provision they seek to enforce. To the extent they believe they can file a breach of contract claim that is consistent with the factual assertions in their pleading, they must identify the provision of the contract that was breached. *They should address to the extent that they were able to do so the other deficiencies in the Complaint to which the defendants refer in their motion papers since they will be given no further opportunity to amend their pleading to cure those deficiencies.*

2006 U.S. Dist. LEXIS 12471, [WL] at *3 (emphasis added).

Appendix C

Plaintiffs filed a third amended complaint, alleging that defendants recommended that investors purchase WorldCom stock solely as a means to retain WorldCom's investment banking business and despite defendants' knowledge of WorldCom's weak prospects. *See Holmes v. Grubman (In re WorldCom, Inc. Sec. Litig.)*, 456 F. Supp. 2d 508, 511 (S.D.N.Y. 2006) ("Holmes II"). The third amended complaint contained the following seven causes of action: (1) fraudulent misrepresentation and omission of WorldCom's financial condition and the defendants' conflict of interest; (2) breach of fiduciary duty; (3) negligent misrepresentation for misleading information and omissions; (4) negligence in making disclosures; (5) violation of Georgia's blue sky laws, as codified at section 10-5-12 of the Annotated Georgia Code; (6) breach of contract; and (7) a "holder" claim—*i.e.*, one based on Holmes's decision, allegedly induced by SSB, to forbear the sale of WorldCom securities—solely to preserve the issue for appeal. *Id.* at 511-12 & n.3. For the first time, plaintiffs alleged that defendants made fraudulent misrepresentations that induced plaintiffs to purchase WorldCom securities prior to June 25, 1999. *Id.* at 511.

Defendants moved to dismiss the third amended complaint for failure to state a claim upon which relief can be granted. *See* Fed. R. Civ. P. 12(b)(6). Granting defendants' motion, the District Court held that (1) the third amended complaint's inclusion of claims arising from pre-June 25, 1999 purchases of WorldCom securities were new claims, untimely raised in the third amended complaint and unauthorized by the March

2006 Opinion, Holmes II, 456 F. Supp. 2d at 513; (2) plaintiffs failed to plead proximate cause with respect to the fraud, negligence, and negligent misrepresentation claims because they did not provide "fair notice of any disclosure that could be said to have played a role in the decline in WorldCom's stock price and that was concealed by the defendants' fraud or negligence," *id.* at 515; [3] (3) the defendants did not owe plaintiffs a fiduciary duty under Georgia law, *id.* at 517-18; (4) the complaint's invocation of Georgia's blue sky law, "Title 10, Chapter 5, Section 12 of the Official Code of Georgia"—which contains twenty-three different prohibitions—did not satisfy the March 2006 Opinion's requirement that plaintiffs plead a violation of a *specific* provision of the statute, *id.* at 518; and (5) plaintiffs would not be given yet another opportunity to re-plead the claim, *id.* Also, the District Court dismissed again plaintiffs' (6) breach of contract claim and (7) "holder" claim. *Id.* at 519.

This appeal followed.

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3. Plaintiffs' WorldCom losses came about in October 2000, prior to the revelation in 2002 of the company's massive accounting fraud and subsequent bankruptcy. *See Holmes II*, 456 F. Supp. 2d at 515 n.7.

Appendix C

DISCUSSION

Before this Court, plaintiffs contend that the District Court erred in (1) denying them leave to amend their complaint to include claims based on their purchases of WorldCom securities prior to June 25, 1999, and (2) in dismissing plaintiffs' blue sky law claims for failure to identify with requisite specificity SSB's alleged violation of Ga. Code Ann. § 10-5-12. According to plaintiffs, the District Court erred in dismissing their remaining claims after predicting that Georgia courts would hold that, under Georgia law, (3) plaintiffs could not be granted relief based on their "holder claims" (4) plaintiffs failed to plead proximate cause, and (5) SSB did not owe plaintiffs a fiduciary duty. [4]

A. Leave To Amend

Pursuant to Rule 15(a)(2) of the Federal Rules of Civil Procedure, "[a] court should freely give leave [to amend] when justice so requires." We review a District Court's denial of leave to amend for abuse of discretion. *See, e.g., McCarthy v. Dun & Bradstreet Corp.*, 482 F.3d 184, 200 -01(2d Cir. 2007); *cf. Sims v. Blot*, 534 F.3d 117, 132 (2d Cir. 2008) ("A district court has abused its discretion if it based its ruling on an erroneous view of the law or on a clearly erroneous assessment of the evidence, or rendered a decision that cannot be located

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4. Plaintiffs do not appeal the District Court's dismissal of their claim for breach of contract, and, accordingly, we consider it abandoned. *See, e.g., Losacco v. City of Middletown*, 71 F.3d 88, 92 (2d Cir. 1995).

within the range of permissible decisions." (internal citations, alterations, and quotation marks omitted)). Generally, "[a] district court has discretion to deny leave for good reason, including futility, bad faith, undue delay, or undue prejudice to the opposing party." *McCarthy*, 482 F.3d at 200. Where, as here, a scheduling order governs amendments to the complaint, *see* Fed. R. Civ. P. 16(b)(4) ("A schedule may be modified only for good cause and with the judge's consent."), "the lenient standard under Rule 15(a), which provides leave to amend 'shall be freely given,' must be balanced against the requirement under Rule 16(b) that the Court's scheduling order 'shall not be modified except upon a showing of good cause.'" *Grochowski v. Phoenix Constr.*, 318 F.3d 80, 86 (2003) (quoting older versions of Federal Rules of Civil Procedure 15(a), 16(b)). Whether good cause exists turns on the "diligence of the moving party." *Id.*

It is undisputed that plaintiffs' motion to "enlarge" their complaint to include pre-1999 purchases was untimely under the District Court's scheduling order. In rejecting Holmes's untimely motion, the District Court concluded that plaintiffs had not been diligent in setting forth claims arising from their pre-1999 purchases of WorldCom and had not shown good cause for their failure to include those claims in earlier versions of the complaint. Specifically, the District Court recounted:

> Holmes had never referred to any claims based on [pre-June 25, 1999] purchases in his

> prior pleadings and motion practice, and as a result, leave to amend was confined to claims based on purchases of WorldCom stock after June 25, 1999. Indeed, in his prior pleadings Holmes'[s] claims hinged on his asserted reliance on a June 25, 1999 telephone conversation. Based on that call, Holmes alleged that he decided to not sell the 2.1 million shares of WorldCom stock that he owned, deciding to hold that stock and acquire an unidentified amount of additional shares after June 25. Based on that cryptic reference to purchases made in reliance on the defendants' representations, Holmes was granted a limited leave to amend his complaint for a fourth time.

Holmes II, 456 F. Supp. 2d at 512-513; *see also id.* at 513 n.4 (explaining that "defendants contend that this is in fact [plaintiffs'] fifth amendment").

We agree with the District Court's assessment of plaintiffs' actions. The record is devoid of evidence supporting plaintiffs' contention that good cause existed for the District Court to modify its scheduling order. Accordingly, we affirm the District Court's denial of Holmes's motion to amend.

B. Georgia's Blue Sky Law

We review *de novo* the District Court's dismissal of plaintiffs' claims for "failure to state a claim upon which

relief can be granted," Fed. R. Civ. P. 12(b)(6). *See, e.g., Burch*, 551 F.3d at 124. We construe plaintiffs' complaint liberally, "accepting all factual allegations in the complaint as true, and drawing all reasonable inferences in the plaintiff's favor." *Id.*

In order to survive a motion to dismiss under Rule 12(b)(6), a complaint must include "a plain statement of the claim . . . [that] give[s] the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests." *Patane v. Clark*, 508 F.3d 106, 113 (2d Cir. 2007) (internal quotation marks omitted) (alterations in original). Plaintiffs' second amended complaint asserted that "[i]n recommending the purchase of WorldCom stock . . . [defendants] violated Title 10 Chapter 5 of the Official Code of Georgia," J.A. at 1631 (2d Am. Compl. P 120), and further alleged that SSB "knowingly made false and misleading statements in proceedings governed by Chapter 5 of the Official Code of Georgia," J.A. at 1631 (2d Am. Compl. P 121). As the District Court noted, that section of the Georgia Code contains twenty-three different prohibitions, many of which proscribe false or misleading statements. *Holmes II*, 456 F. Supp. 2d at 518; *see also* Ga. Code Ann. § 10-5-12 (2008). In dismissing Holmes's second amended complaint, the District Court had stated, "To the extent [plaintiffs] wish to pursue a claim under [Ga. Code Ann. § 10-5-12], [they] must identify the specific provision [they] seek to enforce." *Holmes I*, 2006 U.S. Dist. 12471, 2006 WL 751382, at *3.

Notwithstanding the District Court's instructions, Holmes's third amended complaint neither cited a specific provision of the statute, nor referred to particular false or misleading statements that allegedly violated the statute. The complaint stated simply that "[SSB], as a securities dealer, knowingly made false and misleading statements in proceedings governed by Title 10 Chapter 5 Section 12 of the Official Code of Georgia," J.A. 1872 (3d Am. Compl. P 124). We agree with the District Court that plaintiffs' complaint effectively "obstructed any analysis of whether [plaintiffs'] pleading stat[ed] a claim," under Georgia's securities statute, insofar as the complaint tracks several of the statute's provisions. *Holmes II*, 456 F. Supp. 2d at 518. Because plaintiffs failed to provide SSB with fair notice of their claim and the grounds upon which it rested, the District Court's dismissal of this claim was entirely appropriate.

C. Remaining Claims

The District Court dismissed Holmes's remaining claims, which sounded in Georgia law, after concluding that plaintiffs had not stated grounds for relief. As we explain below, the Supreme Court of Georgia has not addressed the questions necessary for resolving these issues.

1. Holder Claims

The Supreme Court of Georgia has defined one of the elements of the "tort of fraud" as an "intention to induce the plaintiff to act *or refrain from acting*." *Stiefel*

v. Schick, 260 Ga. 638, 398 S.E.2d 194, 195 (Ga. 1990) (emphasis added) (quotation marks omitted). While that court has not applied this rule in the context of fraud claims arising from the holding of publicly traded securities, it has not foreclosed that possibility. The Georgia Court of Appeals, Georgia's intermediate appellate court, has on two occasions touched on the subject. In *Mack v. Smith*, the Georgia Court of Appeals dismissed a fraud claim, in part, because the plaintiffs did not "purchase . . . the securities or investment contracts." 178 Ga. App. 652, 344 S.E.2d 474, 475 (Ga. Ct. App. 1986). More recently, however, the same court affirmed a judgment for plaintiffs who claimed to have been "fraudulently induced into making *and keeping* their investments." *Argentum Int'l, LLC v. Woods*, 280 Ga. App. 440, 634 S.E. 2d 195, 201 (Ga. Ct. App. 2006) (emphasis added).

The District Court acknowledged in a related case that "Georgia courts have not addressed the issue," but nevertheless rejected the "holder claims," citing "the inherent difficulty of proving reliance and damages in such actions, as well as the potential for non-meritorious suits brought merely to extract a settlement," and the possibility that "holder claims would throw open to the trier of fact many rather hazy issues of historical fact the proof of which depended almost entirely on oral testimony about largely conjectural and speculative damages." *Weinstein v. Ebbers (In re WorldCom, Inc. Sec. Litig.)*, 336 F. Supp. 2d 310, 319 (S.D.N.Y. 2004) (internal quotation marks omitted). The District Court also noted that individuals who have not actually

purchased securities are not entitled to sue under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq. See In re WorldCom, Inc. Sec. Litig.*, 336 F. Supp. 2d at 319 (citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 749, 95 S. Ct. 1917, 44 L. Ed. 2d 539 (1975)).

Plaintiffs argue that "holder claims" would be recognized under Georgia law because forbearance, an induced failure to act, has long been recognized as a valid basis for claims sounding in fraud. *See, e.g.*, Restatement (Second) of Torts § 525 (1977) ("One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or *to refrain from action in reliance upon it*, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation." (emphasis added)); *cf. Gullock v. Spectrum Scis. & Software, Inc.*, 146 F. Supp. 2d 1364, 1375 n.10 (M.D. Ga. 2001) ("The Supreme Court of Georgia has routinely cited to [the] Restatement of Torts for positive authority . . . .") (collecting cases). Plaintiffs further note that several states—including California, New York, and New Jersey—recognize fraud claims based on forbearance in the sale of publicly traded securities. Among other cases, plaintiffs rely on *Small v. Fritz Companies, Inc.*, in which the Supreme Court of California first recognized "holder claims," based in part on its observation that the risk of nonmeritorious suits "[could] not justify a blanket rule of nonliability" for those who knowingly used false or misleading information to induce individuals to hold

securities. 30 Cal. 4th 167, 132 Cal. Rptr. 2d 490, 65 P.3d 1255, 1264 (Cal. 2003); *see also Gutman v. Howard Sav. Bank*, 748 F. Supp. 254, 264 (D.N.J. 1990) (upholding a "holder claim," noting that "[l]ies which deceive and injure do not become innocent merely because the deceived continue to do something rather than begin to do something else") (New York and New Jersey law).

SSB counters that the Supreme Court of Georgia would bar "holder claims" on policy grounds similar to those cited by the District Court. According to SSB, "holder claims" involve (1) incoherent theories of proximate cause and damages, (2) speculative damages, and (3) unprovable claims of a subjective intent to sell. SSB further observes that at least seven other states—Connecticut, Delaware, Illinois, Minnesota, Pennsylvania, Mississippi, and Texas—do not recognize "holder claims." *See* Appellee's Br. at 11 (citing, in alphabetical order by state, *Chanoff v. U.S. Surgical Corp.*, 857 F. Supp. 1011, 1018 (D. Conn. 1994) (Connecticut law); *Manzo v. Rite Aid Corp.*, No. Civ. A 18451-NC, 2002 Del. Ch. LEXIS 147, 2002 WL 31926606, at *5 (Del. Ch. Dec. 19, 2002) (Delaware law); *Kagan v. Edison Bros. Stores, Inc.*, 907 F.2d 690, 692 (7th Cir. 1990) (Illinois law); *Arent v. Distrib. Scis., Inc.*, 975 F.2d 1370, 1374 (8th Cir. 1992) (Minnesota law); *Crocker v. FDIC*, 826 F.2d 347, 350-51 (5th Cir. 1987) (Mississippi law); *WM High Yield Fund v. O'Hanlon*, No. Civ. A. 04-3423, 2005 U.S. Dist. LEXIS 33569, 2005 WL 1017811, at *13 (E.D. Pa. Apr. 29, 2005) (Pennsylvania law); *In re Enron Corp. Sec. Derivative & "ERISA" Litig.*, No.

MDL-1446, 2007 U.S. Dist. LEXIS 17374, 2007 WL 789141, at *13 (S.D. Tex. Mar. 12, 2007) (Texas law)). [5]

2. Proximate Cause

Plaintiffs' theory is that defendants knew of the impending collapse of WorldCom stock value but nevertheless gave Holmes inaccurate advice that plaintiffs relied upon in deciding not to sell their WorldCom securities on June 25, 1999. Under Georgia law, whether the conduct of a "tortfeasor is the proximate cause of a subsequent injury is determined by asking whether the subsequent injury was a reasonably foreseeable consequence of the original tortious act." *De Kalb County Hosp. Auth. v. Davis*, 250 Ga. 46, 295 S.E.2d 840, 841 (Ga. 1982); *see also* Restatement (Second) of Torts § 548A ("A fraudulent misrepresentation is a legal cause [*i.e.*, proximate cause] of a pecuniary loss resulting from action or inaction in reliance upon it if, but only if, the loss might reasonably be expected to result from the reliance."). While plaintiffs concede, as they must, that the Supreme Court of Georgia has not applied this rule in the context of securities litigation, they aver that their theory is cognizable as an element of fraud under existing Georgia common law.

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5. Defendants' brief also cites *Sit-Set, A.G. v. Universal Jet Exchange, Inc.*, 747 F.2d 921, 928-29 (4th Cir. 1984), for the proposition that Virginia does not recognize "holder claims." Appellee's Br. at 12 n.1. However, Sit-Set addresses only the "wantoness[] or malice" required to support a punitive damages award. *See Sit-Set*, 747 F.2d at 928-29.

The District Court held that, for "tort claims based on misrepresentations or omissions concerning securities," proximate cause can be satisfied only if plaintiffs plead "that the truth concealed by the defendant entered the market place" and thereby caused the stock price to drop. *Holmes II*, 456 F. Supp. 2d at 514. The District Court drew its conclusion from its brief analysis of *Dura Pharmaceuticals, Inc. v. Brudo*, which was a "fraud-on-the-market" case involving federal securities statutes, 544 U.S. 336, 342, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005), and from a consideration of secondary sources, *see Holmes II*, 456 F. Supp. 2d at 515 (discussing Restatement (Second) of Torts § 548A cmt. a & b. and Prosser & Keeton, The Law of Torts, § 110 (W. Page Keeton ed., 5th ed. 1984)). The District Court concluded that "[t]here is no reason to believe that the Georgia common law embodies any different standard" than the sources analyzed by the District Court. *Id.*

3. Fiduciary Duty

The Georgia statute governing the existence of fiduciary duties provides:

> Any relationship shall be deemed confidential, whether arising from nature, created by law, or resulting from contracts, where one party is so situated as to exercise a controlling influence over the will, conduct, and interest of another or where, *from a similar relationship of mutual confidence*, the law

> requires the utmost good faith, such as the relationship between partners, *principal and agent*, etc.

Ga. Code Ann. § 23-2-58 (2008) (emphases added).

Here, plaintiffs' accounts with SSB were self-directed, or "non-discretionary," meaning that neither SSB nor its brokers had discretion to invest plaintiffs' assets absent plaintiffs' direction. Interpreting the "controlling influence" requirement of Georgia's fiduciary duty statute, the District Court held that "[i]n Georgia, a broker only becomes a 'full-fledged fiduciary' of his client where the client has entrusted the broker with control over a discretionary trading account." *Holmes II*, 456 F. Supp 2d at 517 (quoting *Prudential Bache Sec., Inc. v. Pitman ("Pitman")*, No. 1:89-CV-85, 1991 U.S. Dist. LEXIS 10056, 1991 WL 160039, at *4 (N.D. Ga. Apr. 4, 1991) ("In a non-discretionary account, the broker acts only upon the customer's instructions and the customer determines all purchases and sales. In a discretionary account, the broker has the authority to make trades on the broker's own initiative for the best interests of the customer. It is only with a discretionary account that the broker becomes a full-fledged fiduciary of the customer.")).

Plaintiffs argue that, under Georgia law, brokerage firms owe holders of nondiscretionary accounts a fiduciary duty arising from a principal-agent relationship. More specifically, plaintiffs contend that SSB owed them, at the very least, "a fiduciary duty of

good faith, which includes the duty not to misrepresent material facts." Appellants' Br. at 55. According to plaintiffs, decisions by Georgia's intermediate appellate court belie the District Court's view. Among other cases, plaintiffs cite *Glisson v. Freeman*, in which the Georgia Court of Appeals observed that

> [a] stockbroker's duty to account to its customer is fiduciary in nature, so that the broker is obligated to exercise the utmost good faith. Requirements of good faith demand that in the principal's interest it is the agent's duty to make known to the principal all material facts which concern the transactions and subject matter of his agency.

243 Ga. App. 92, 532 S.E.2d 442, 449 (Ga. Ct. App. 2000) (citations omitted) (alteration in original). The Georgia Court of Appeals further noted that "[w]ith respect to a nondiscretionary account, . . . the broker owes a number of duties to the client, including . . . the duty not to misrepresent any fact material to the transaction," but did not explicitly indicate whether the broker of a nondiscretionary account owes his client a fiduciary duty. *Id; cf.* Restatement (Third) of Agency § 8.01 cmt. b (2006) ("An agent's failure to provide material information to the principal may facilitate the agent's breach of the agent's duties of loyalty to the principal.")

We note that the Supreme Court of Georgia has never held that a brokerage firm owes—or does not owe—a fiduciary duty to the holder of a

nondiscretionary account. Nor has the Supreme Court of Georgia indicated its position on the related question of whether a brokerage firm and the holder of a nondiscretionary account are agent and principal, such that their relationship might give rise to fiduciary duties under Ga. Code Ann. § 23-2-58.

D. Certification

Georgia law permits the Georgia Supreme Court to accept from any circuit court of appeals of the United States "questions of the laws of [Georgia] which are determinative of [a] case . . . [if] there are no controlling precedents in decisions of the Supreme Court [of Georgia]." Ga. Code Ann., § 15-2-9 (2008); see also Ga. Const. Art. VI, § VI, Para. IV ("The Supreme Court shall have jurisdiction to answer any question of law from any state appellate or federal district or appellate court. . . ."); Ga. S. Ct. R. 46 ("When it shall appear to the Supreme Court of the United States, or to any Circuit Court of Appeals of the United States, or to any state appellate court, that there are involved in any proceeding before it questions or propositions of the laws of this State which are determinative of said cause and there are no clear controlling precedents in the appellate court decisions of this State, such court may certify such questions or propositions of the laws of Georgia to this Court for instructions.").

Although Georgia's certification criteria are met in this case, we do not certify a question of unsettled state law merely because state law permits it. Whether we

ask a state court to resolve unsettled legal questions will depend on, among other factors: "(1) the absence of authoritative state court decisions; (2) the importance of the issue to the state; and (3) the capacity of certification to resolve the litigation." *O'Mara v. Town of Wappinger*, 485 F.3d 693, 698 (2d Cir. 2007); *see also Morris v. Schroder Capital Mgmt. Int'l*, 445 F.3d 525, 531 (2d Cir. 2006) (same); *Green v. Montgomery*, 219 F.3d 52, 60 (2d Cir. 2000) (same). [6]

We conclude that each of the three unresolved issues in this case is appropriate for certification to the Supreme Court of Georgia. First, with respect to each issue, we find no definitive guidance in Georgia law. As the District Court acknowledged, Georgia courts have not provided guidance as to whether, under Georgia common law, a plaintiff may bring "holder claims" for induced forbearance in the sale of securities. Similarly, the District Court correctly noted that Georgia courts have not decided whether a plaintiff may establish a *prima facie* case for securities fraud without alleging

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6. We do not consider these factors necessarily to constitute the sum total of an analysis of certification to a state court. *See, e.g., Reliance Ins. Co. v. Polyvision Corp.*, 474 F.3d 54, 58 (2d Cir. 2007) (characterizing the same three factors noted in *O'Mara* as "three *principal* issues" (emphasis added)); *Tinelli v. Redl*, 199 F.3d 603, 606 n.5 (2d Cir. 1999) (noting that "[c]ertification . . . is not proper where the question does not present a complex issue, there is no split of authority and sufficient precedents exist for us to make [a] determination" (internal quotation marks omitted)). However, we note that in this case these factors are both necessary and sufficient for our analysis.

that the information allegedly withheld by defendants entered the marketplace and caused the value of securities to decrease.

Whether Georgia courts have considered whether a broker managing a non-discretionary account owes his client a fiduciary duty merits brief discussion. As noted, the District Court relied on a ruling from the Northern District of Georgia for the proposition that, under Georgia law, brokers managing non-discretionary accounts are not "full-fledged fiduciar[ies]." *Holmes II*, 456 F. Supp 2d at 517 (quoting *Pitman*, 1991 U.S. Dist. LEXIS 10056, 1991 WL 160039, at *4). While we have suggested that, under certain circumstances, it may be appropriate to accord some measure of deference to a federal district court's interpretation of the laws of the state in which the court is located, *see Factors Etc., Inc. v. Pro Arts, Inc.*, 652 F.2d 278, 281 (2d Cir. 1981) ("It has frequently been observed that a court of appeals should give considerable weight to state law rulings made by district judges within the circuit, who possess familiarity with the law of the state in which their district is located."), deference is not appropriate in this case. The District Court's order in *Pitman* does not purport to rely Georgia law for the observation at issue. Instead, *Pitman* cites an opinion from the Eastern District of Michigan that did not apply Georgia law. *See Pitman*, 1991 U.S. Dist. LEXIS 10056, 1991 WL 160039 at *4 (citing *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 461 F. Supp 951, 953 (E.D. Mich. 1978)). It appears that, aside from the District Court's decision in the instant case, no court has cited *Pitman* as an authoritative interpretation of Georgia law.

The two remaining factors also weigh in favor of certification. Each issue is of central importance to securities litigation under Georgia law, and resolution of each issue could affect in a significant way businesses and individual investors in the state. Finally, each issue is critical to the resolution of this litigation. If the Supreme Court of Georgia agrees with the District Court's characterization of Georgia law, then the cause will be resolved immediately in favor of defendants. If the Supreme Court of Georgia reaches different conclusions, then plaintiffs may be able to proceed with their claims against SSB in the Southern District of New York.

Accordingly, we certify the following questions to the Supreme Court of Georgia:

I. Does Georgia common law recognize fraud claims based on forbearance in the sale of publicly traded securities?

II. With respect to a tort claim based on misrepresentations or omissions concerning publicly traded securities, is proximate cause adequately pleaded under Georgia law when a plaintiff alleges that his injury was a reasonably foreseeable result of defendant's false or misleading statements but does not allege that the truth concealed by the defendant entered the market place, thereby

precipitating a drop in the price of the security?

III. Under Georgia law, does a brokerage firm owe a fiduciary duty to the holder of a non-discretionary account?

The Supreme Court of Georgia may reformulate or expand upon these questions as it sees fit, based on the record of this case.

CONCLUSION

For the reasons stated above, the October 13, 2006 order of the District Court is AFFIRMED insofar as it dismissed plaintiffs' claims arising from their purchases of WorldCom securities prior to June 25, 1999.

Three questions are CERTIFIED to the Georgia Supreme Court.

The Clerk of the Court shall transmit to the Supreme Court of Georgia a notice of certification, together with a copy of this opinion and a complete record of the case, including the set of briefs, appendices, and record filed by the parties in this Court. This panel will retain responsibility for the decision of this case until we have reviewed the response of the Supreme Court of Georgia to our certification.

The parties shall bear equally any costs or fees imposed by the Supreme Court of Georgia.

APPENDIX D — OPINION AND ORDER OF THE UNITED STATES DISTRICT SOUTHERN DISTRICT OF NEW YORK DATED OCTOBER 13, 2006

MASTER FILE
02 Civ. 3288 (DLC)

04 Civ. 8303 (DLC)

IN RE WORLDCOM, INC. SECURITIES LITIGATION,

This document relates to:

WILLIAM K. HOLMES, HOLMES CAPITAL, LLC, BREW DOG, LLC, BIMINI STAR, LLC, and EBH INVESTMENTS CO., LLC,

Plaintiffs,

-v-

JACK GRUBMAN, and CITIGROUP GLOBAL MARKET INC., F/K/A SMITH BARNEY & CO., INC.,

Defendants.

OPINION AND ORDER

Appendix D

DENISE COTE, District Judge

This Opinion addresses a motion to dismiss the third amended complaint filed in an Individual Action brought within the context of the *WorldCom Securities Litigation*, [1] a motion to enlarge permission to amend, and a motion to remand the case to the bankruptcy court in Georgia. For the following reasons, the motion to dismiss is granted, the motion to enlarge is denied in part, and the motion to remand is denied.

Background

William K. Holmes and entities which he controls ("Holmes") filed this action in June 2003 in the United States Bankruptcy Court for the Middle District of Georgia. The case was transferred to this Court and consolidated for pre-trial purposes with the *Securities Litigation*. [2] On March 24, 2006, the motion to dismiss

1. The history of both WorldCom's collapse and the resulting litigation has been described in many prior opinions by this Court. *See, e.g., In re WorldCom, Inc. Sec. Litig.*, 2004 U.S. Dist. LEXIS 22992, 02 Civ. 3288 (DLC), 2004 WL 2591402 (S.D.N.Y. Nov. 12, 2004) (approval of consolidated class action settlement with Citigroup defendants); *In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628 (S.D.N.Y. 2004) (addressing Underwriter Defendants ' motion for summary judgment); *In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d 392 (S.D.N.Y. 2003) (deciding a number of defendants' motions to dismiss class action, including the motion of Citigroup, Inc., Salomon Smith Barney and Jack Grubman).

2. The terms and references in this Opinion are those customarily used in Opinions in the *WorldCom Securities Litigation*. *See, e.g., In re WorldCom, Inc. Sec. Litig.*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402; *In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d 392.

the second amended complaint in the Holmes action was granted. *Holmes v. Grubman (In re Worldcom, Inc.), 2006 U.S. Dist. LEXIS 12471, No. 02 Civ. 3288 (DLC), 2006 WL 751382 (S.D.N.Y. Mar. 24, 2006)* ("March 2006 Opinion"). That pleading attempted to state "holder" claims. Specifically, Holmes sought recovery under Georgia law based on his assertion that his broker convinced him not to sell 2.1 million shares of WorldCom stock that he owned by referring to the defendants' June 25, 1999 research report concerning WorldCom.

Holmes did not request an opportunity to amend, but the Court *sua sponte* gave the plaintiff a limited opportunity to amend since the complaint referred as well to a purchase of an unidentified number of WorldCom shares after June 25, 1999. Among other things, Holmes was required in any amended pleading to identify with specificity purchases of WorldCom stock after June 25, 1999, the provision of the Georgia statute on which he was relying to assert his statutory claim, and the provision of any contract which he asserted the defendants had breached. Holmes' third amended complaint lists purchases of WorldCom securities after April 9, 1998. As for purchases after June 25, 1999, Holmes identifies purchases of stock on ten separate days up to July 20, 2000, and purchases of call options up to September 2000. All of his investments in WorldCom securities were involuntarily sold by September 2000 to pay margin calls.

In this most recent pleading, Holmes asserts that the defendants Jack B. Grubman and Citigroup Global

Appendix D

Market Inc. f/k/a Smith Barney & Co., Inc. ("Citigroup Defendants") made negligent and fraudulent misrepresentations that induced him to purchase WorldCom securities. Grubman was the telecommunications analyst at Smith Barney, where Holmes had a brokerage account. Holmes asserts that the defendants operated under a conflict of interest from April 1998, providing underwriting services to WorldCom at the same time as they were recommending to investors that they purchase WorldCom securities. Holmes asserts further that the defendants made recommendations to investors to buy WorldCom stock when they knew that an honest assessment of WorldCom would yield a conservative target price for WorldCom stock, but that that honest assessment would also result in the defendants' loss of investment banking fees.

According to Holmes, from June 25, 1999 onwards, the defendants were blindly bullish towards WorldCom, as its stock fell in price from $ 92 per share to roughly $ 25 per share in October 2000. In early 2000, Grubman changed his valuation method to permit him to continue to support the target price for WorldCom stock in the face of WorldCom's shrinking revenue stream. Grubman abandoned a discounted free cash flow valuation methodology, a methodology which is affected by consideration of a company's capital expenditures.

During this period, Holmes was in almost daily contact with his financial advisor Charles M. Parker, who provided him with the defendants' research reports. Both Parker and Holmes relied on those research

reports in their discussions of WorldCom, and Holmes relied on them in making his decision to purchase WorldCom securities. Holmes lists fourteen recommendations by the defendants to investors to buy WorldCom stock between June 25, 1999 and October 2000.

The third amended complaint pleads six causes of action. The first is asserted against both defendants; the remaining are asserted solely against Smith Barney. The first cause of action is for fraudulent misrepresentation and omissions of WorldCom's true financial condition and the defendants' conflict of interest. The second pleads a breach of fiduciary duty. The third and fourth assert negligent misrepresentation for misleading information and omissions, and negligence in making disclosures. The fifth cause of action asserts a violation of Title 10, Chapter 5, Section 12 of the Official Code of Georgia. The final claim is for breach of contract. [3]

Meanwhile, on February 1, 2006, Holmes requested that his action be remanded to the Georgia bankruptcy court. That motion was fully submitted on March 2, just weeks before his second amended pleading was dismissed in its entirety. That motion would have been denied on the merits, but in any event was rendered moot by the dismissal and has not been renewed.

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3. In a seventh claim, Holmes reasserts the dismissed "holder" claim in order to preserve the theory for appellate review.

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Discussion

A complaint must contain "a short and plain statement of the claim showing that the pleader is entitled to relief." Rule 8(a)(2), Fed. R. Civ. P. The purpose of this requirement is to give fair notice of a claim and the grounds upon which it rests so that the opposing party may identify the nature of the case, respond to the complaint, and prepare for trial. *Swierkiewicz v. Sorema, N.A.*, 534 U.S. 506, 512, 122 S. Ct. 992, 152 L. Ed. 2d 1 (2002). Rule 8 is fashioned in the interest of fair and reasonable notice, not technicality, and therefore is "not meant to impose a great burden upon a plaintiff." *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 347, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005). "The complaint thus need not set out in detail the facts upon which the claim is based." *Twombly v. Bell Atlantic Corp.*, 425 F.3d 99, 107 (2d Cir. 2005) (citation omitted). If it is clear, however, that "no relief could be granted under any sets of facts that could be proved consistent with the allegations," the claim should be dismissed. *Swierkiewicz, 534 U.S. at 514*. In construing the complaint, the court must "accept all factual allegations in the complaint as true and draw inferences from those allegations in the light most favorable to the plaintiff." *Jaghory v. New York State Dep't of Educ.*, 131 F.3d 326, 329 (2d Cir. 1997).

"The Rules do establish more demanding pleading requirements for certain kinds of claims." *Twombly*, 425 F.3d at 107. These claims, including fraud, must "be stated with particularity." Rule 9(b), Fed. R. Civ. P. To

comply with the requirements of Rule 9(b), an allegation of fraud must specify: "(1) those statements the plaintiff thinks were fraudulent, (2) the speaker, (3) where and when they were made, and (4) why plaintiff believes the statements to be fraudulent." *Koehler v. Bank of Bermuda (New York) Ltd.*, 209 F.3d 130, 136 (2d Cir. 2000).

1. Pre-June 25, 1999 Purchases

The defendants move to dismiss all claims to the extent that they are based on purchases before June 25, 1999. Holmes had never referred to any claims based on such purchases in his prior pleadings and motion practice, and as a result, leave to amend was confined to claims based on purchases of WorldCom stock after June 25, 1999. Indeed, in his prior pleadings Holmes' claims hinged on his asserted reliance on a June 25, 1999 telephone conversation. Based on that call, Holmes alleged that he decided to not sell the 2.1 million shares of WorldCom stock that he owned, deciding to hold that stock and acquire an unidentified amount of additional shares after June 25. Based on that cryptic reference to purchases made in reliance on the defendants' representations, Holmes was granted a limited leave to amend his complaint for a fourth time. [4]

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4. The defendants contend that this is in fact Holmes' *fifth amendment*.

Relying on the standard for amendment that applies under Rule 15, Fed. R. Civ. P., Holmes moved on June 9 to enlarge the ruling in the March 2006 Opinion to permit him to plead claims based on purchases of WorldCom stock and options prior to June 25, 1999. This motion is an untimely motion for reconsideration of the March 2006 Opinion, and may be denied on that ground alone. S.D.N.Y. R. 6.3. *See also, Lichtenberg v. Besicorp Group Inc.*, 204 F.3d 397, 402 (2d Cir. 2000) (finding motion for reconsideration of injunction under S.D.N.Y. Local Rule 6.3 untimely when filed after more than ten days of entry of injunction).

In addition, the standard for amendment that applies to Holmes' Third Amended Complaint is good cause, since the amendment is governed by a scheduling order. See Rule 16, Fed. R. Civ. P.; *Grochowski v. Phoenix Constr.*, 318 F.3d 80, 86 (2d Cir. 2003); *Parker v. Colum. Pictures Indus.*, 204 F.3d 326, 340 (2d Cir. 2000); *In re Wireless Tel. Servs. Antitrust Litig.*, 2004 U.S. Dist. LEXIS 19977, No. 02 Civ. 2637 (DLC), 2004 WL 2244502, at *5 (S.D.N.Y. Oct. 6, 2004). Holmes has not shown good cause to add claims based on purchases before June 25, 1999.

Pursuant to the Order of Consolidation in the *Securities Litigation*, Holmes had twenty-one days following the arrival of his case on this Court's docket to file an amended complaint. Shortly after that period expired, Holmes moved to amend, and permission was granted. March 2006 Opinion, 2006 U.S. Dist. LEXIS 12471, [WL] at *1. Holmes captioned that amended

pleading as the Second Amended Complaint. By that time, Holmes was fully on notice that holder claims were not cognizable under Georgia law. *Weinstein v. Ebbers (In re WorldCom, Inc. Sec. Litig.)*, 336 F. Supp. 2d 310, 322-23 (S.D.N.Y. Sept. 17, 2004). Despite that notice, Holmes persisted in restating his holder claims on December 2, 2004, and made only oblique reference to some kind of claim for purchases of WorldCom stock after June 25, 1999. Having failed to show diligence or good cause, the claims based on purchases before June 25, 1999, are stricken. [5]

2. Post-June 25, 1999 Options Purchases

The Citigroup Defendants also move to strike any claim for damages based on the purchase of options after June 25, 1999, as beyond the scope of amendment permitted by the March 2006 Opinion. They do not contend, however, that the Opinion precludes Holmes from seeking damages based on shares acquired after June 25, 1999, either by exercising options or by using the proceeds of derivative transactions to make the purchases. They do assert that the March 2006 Opinion may not properly be read to give Holmes an opportunity to amend to add claims based on securities purchases other than the purchases of WorldCom stock after June 25, 1999.

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5. It should be noted that Holmes did not file a reply brief in support of his motion to enlarge, and has not otherwise tried to excuse the untimely filing of his *de facto* motion for reconsideration or to explain how he meets the Rule 16 requirement that he show diligence.

While a strict reading of the March 2006 Opinion supports the defendants' view, the Opinion did not focus on the nature of the securities purchased after June 25, 1999. Therefore, to the extent Holmes can state a cause of action for purchases of WorldCom options after June 25, 1999, he may include a claim for damages based on that trading.

3. Fraud, Negligence, Negligent Misrepresentation

The Citigroup Defendants move to dismiss the claims for fraud, negligence, and negligent misrepresentation[6] on the grounds that Holmes has failed to plead facts that give fair notice of 1) his theory of proximate causation; 2) any statement by the defendants that could support a claim of reliance; and 3) any actionable statements of fact by the defendants (as opposed to opinion). It is only necessary to address the first of these arguments.

Proximate causation is an element of a claim of fraud under Georgia law. *Taylor v. Bennett Chevrolet/Buick, Inc.*, 271 Ga. App. 300, 609 S.E.2d 215, 217 (Ga. Ct. App. 2005). Similarly, proximate causation is one of the elements of a claim of negligence under Georgia law. *Cieplinski v. Caldwell Elec. Contractors*, 280 Ga. App. 267, 633 S.E.2d. 646, 650 (Ga. Ct. App. 2006); *Newitt v.*

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6. Holmes claims for negligence and negligent misrepresentation may be treated as a single claim. *BDO Seidman, LLP v. Mindis Acquisition Corp.*, 276 Ga. 311, 578 S.E.2d 400, 401 (Ga. 2003) (noting that negligent misrepresentation claims sound in negligence).

First Union National Bank, 270 Ga. App. 538, 607 S.E.2d 188, 196 (Ga. Ct. App. 2004) (setting forth the elements for a negligent misrepresentation claim). In a negligence action, a plaintiff must show that she "sustained economic injury proximately resulting from" reliance on the false information. *Newitt*, 607 S.E.2d at 196. Proximate cause requires proof that "but for" the wrongful act the injury would not have occurred, and proof that the injury "can be traced directly" to the wrongful act. *Glisson v. Freeman*, 243 Ga. App. 92, 532 S.E.2d 442, 455 (Ga. Ct. App. 2000). Proximate cause is "the efficient cause" of the injury, and "there may be more than one proximate cause." Id. A cause that is "merely incidental is not the proximate and responsible" cause of injury. *Eldred v. Blue Cross & Blue Shield of Ga.*, 274 Ga. App. 798, 619 S.E.2d 331, 333 (Ga. Ct. App. 2005).

The common law doctrine of proximate causation is well established in American tort law. Proximate cause is the doctrine which limits a defendant's responsibility for the consequence of his acts. *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258, 268, 112 S. Ct. 1311, 117 L. Ed. 2d 532 (1992). It demands some direct relation between the injury which is asserted and the wrongful conduct of the defendant. *Id.* There have been many rationales for requiring proof of proximate cause in tort claims, including the fact that "the less direct an injury is, the more difficult it becomes to ascertain the amount of a plaintiff's damages attributable to the violation as distinct from other, independent factors." *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 126 S.

Ct. 1991, 1997, 164 L. Ed. 2d 720 (2006). Without the concept of proximate causation, courts would be forced "to adopt complicated rules apportioning damages among plaintiffs removed at different levels of injury" from the wrongdoing. *Holmes*, 503 U.S. at 269. Requiring proof of proximate causation in tort litigation removes these burdens while allowing suits to proceed by those who are more directly injured. *Anza*, 126 S. Ct. at 1998.

Applying the principle of proximate causation to tort claims based on misrepresentations or omissions concerning securities requires an assertion that the truth concealed by the defendant entered the market place. With such an assertion, a trading loss can be said to have been proximately caused by a prior misrepresentation. *See Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 342, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005). In the absence of a disclosure, the misrepresentation has simply permitted the stock to trade at an inflated price. Until the concealed information is disclosed, a drop in price may reflect any number of things, but it will not reflect the impact of the misrepresentation or omission on the stock price.

Id. at 343. These principles are widely recognized preconditions for tort recovery. For example, as explained in the Second Restatement of Torts, "[n]ot all losses that in fact result from the reliance are, however, legally caused by the representation. In general, the misrepresentation is a legal cause only of those pecuniary losses that are within the foreseeable

risk of harm that it creates." Restatement (Second) of Torts § 548A cmt. a & b (1977). The Restatement considers a demonstration of proximate causation essential for finding liability in the case of misrepresentations or omissions concerning securities.

> [O]ne who misrepresents the financial condition of a corporation in order to sell its stock will become liable to a purchaser who relies upon the misinformation for the loss that he sustains *when the facts as to the finances of the corporation become generally known and as a result the value of the shares is depreciated on the market*, because that is the obviously foreseeable result of the facts misrepresented. On the other hand, there is no liability when the value of the stock goes down after the sale, not in any way because of the misrepresented financial condition, but as a result of some subsequent event that has no connection with or relation to its financial condition.

Id. (emphasis added). Similarly, the leading treatise on tort law explains that recovery of consequential damages, such as the loss in the value of securities, requires proof that the "consequential . . . damages" were "proximately caused by the fraudulent conduct." Prosser and Keeton, The Law of Torts, § 110 (W. Page Keeton ed., 5th ed. 1984). Recovery is restricted "to those losses which might be expected to follow from the fraud and from events that are reasonably foreseeable."

Id. Losses caused by factors unrelated to the misrepresentation are not proximately caused by it and are not recoverable.

> [I]f the false statements are made in connection with the sale of corporate stock, losses due to a subsequent decline in the market, or insolvency of the corporation brought about by business conditions or other factors in no way relate [sic] to the representations will not afford any basis for recovery. It is only where the fact misstated was of a nature calculated to bring about such a result that damages for it can be recovered.

Id. There is no reason to believe that the Georgia common law embodies any different standard. In pleading a cause of action in tort under Georgia law, a plaintiff must plead that the damages for which he seeks recovery were "proximately caused by the breach." *Tante v. Herring,* 264 Ga. 694, 453 S.E.2d 686, 687 (Ga. 1994) (citing Prosser & Keaton, The Law of Torts, § 30).

Holmes has not pleaded proximate causation. He has not given fair notice of any disclosure that could be said to have played a role in the decline in WorldCom's stock price and that was concealed by the defendants' fraud or negligence. [7]

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7. Holmes' omission in this regard is not surprising. The *WorldCom Securities Litigation* has proceeded largely on the theory that WorldCom engaged in a massive accounting fraud. That fraud did not begin to come to light until early 2002, long

(Cont'd)

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Holmes contends that it is enough for him simply to have pleaded that "but for" for defendants' statements he would not have purchased the WorldCom securities. He contends that it is "of no avail" to defendants that his losses may have been due to "market decline." He is wrong. Factual injury is not proximate causation. *Holmes*, 503 U.S. at 266 & n.11. See Tante, 453 S.E.2d at 687 (implicitly rejecting but for standard).

Holmes argues that he need not identify any linkage between the defendants' statements and his loss since adopting that rule of proximate causation "would allow brokerage firms to lie to their clients with impunity about the nature of the investments they recommend

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(Cont'd)
after Holmes' entire portfolio in WorldCom securities had been liquidated to meet margin calls. *See In re WorldCom, Inc. Sec. Litig.*, 388 F. Supp. 2d 319, 346 (S.D.N.Y. Sept. 21, 2005) (the earliest identified partial disclosure of fraud was January 29, 2002). To the extent that the Citigroup Defendants' conflict of interest in touting WorldCom has been pleaded in the *Securities Litigation*, it has been as an adjunct to the allegations about the accounting fraud, and to assertions that Grubman was actually aware that WorldCom was misrepresenting its financial condition to the public. *See, e.g., In re WorldCom*, 294 F. Supp. 2d at 404-05, 424-26. Even if it were possible to plead a negligence or fraud claim based on the conflict of interest theory alone, Holmes has not pointed to any public disclosure of the conflict that could be said to have contributed to the drop in the price of WorldCom's securities between June 1999 and October 2000, the month in which his portfolio was involuntarily liquidated.

and never face liability." [8] Not so. To the extent that a plaintiff is able to plead that the loss she suffered is attributable to the disclosure of information linked to the broker's lies about the nature of the investments, then she may state (and recover on) a claim against the brokerage firm. Without that linkage, however, the "lies" cannot be said to have been the proximate cause of any injury to the client. "[D]amage proximately caused by the breach" of a duty to a plaintiff is a necessary part of the "traditional formula for elements necessary to a cause of action in tort." *Tante,* 453 S.E.2d at 687.

Finally, Holmes relies on *In re Parmalat Sec. Litig.*, 375 F. Supp. 2d 278 (S.D.N.Y. 2005), for the proposition

8. In resisting this motion to dismiss, Holmes at times characterizes his pleading as presenting the theory that the defendants concealed that the revenues they forecasted for WorldCom were "not coming to fruition", and that Grubman manipulated his methodology "to conceal the declining forecasted revenue." In his pleading, Holmes has intentionally kept his theory of liability vague. To the extent that these statements in his memorandum refer to the fact that WorldCom's revenue or stock price was not meeting publicly predicted target prices, that was an entirely public matter, and not a fact that was or could have been concealed or misrepresented by either defendant. To the extent that this is intended as a reference to WorldCom's unreported, internal financial condition, Holmes has not rested his Third Amended Complaint on an allegation that WorldCom was engaged in accounting irregularities during the time of his investment or identified any public disclosure of WorldCom's internal financial condition during his investment that was concealed by the defendants.

that a corrective disclosure is not necessary where the subject of the misrepresentations caused the loss. *Parmalat* provides no comfort to Holmes. The fraud at issue in *Parmalat* concealed the extent of the company's debt. The risk associated with that concealment materialized when the company suffered a liquidity crisis and its shares lost almost one-half of their value. *Id.* at 306-307. Holmes has not identified any materialization of any risk concealed or misrepresented by the defendants that could be said to have proximately caused his alleged losses.

In sum, Holmes' Third Amended Complaint proceeds under a theory that the defendants concealed the extent of their conflicted relationship with WorldCom and WorldCom's "true financial strength", and that that conflict caused them to recommend that the public generally and customers of Smith Barney in particular, including Holmes, purchase WorldCom securities. Holmes' claims for fraud, negligence, and negligent misrepresentation each require that he plead that any injury he sustained from purchasing WorldCom securities between June 25, 1999 and October 2000 was proximately caused by that fraud or negligence. Because he has not given the defendants fair notice of his theory of proximate causation, that is, how any risk concealed by the defendants materialized before his portfolio was involuntarily sold, these claims must be dismissed.

4. Fiduciary Duty

The Citigroup Defendants move to dismiss the claim for breach of fiduciary duty because Holmes has not alleged the existence of a fiduciary duty under Georgia law. Holmes did not have a discretionary account with Smith Barney, and relies on his contention that a fiduciary duty nonetheless existed because he had a relationship of "mutual confidence" with his broker.

The existence of a fiduciary relationship is governed by statute in Georgia. *Bowen v. Hunter, Maclean, Exley & Dunn,* 241 Ga. App. 204, 525 S.E.2d 744, 748 (Ga. Ct. App. 1999). The statute provides:

> Any relationship shall be deemed confidential, whether arising from nature, created by law, or resulting from contracts, where one party is so situated as to exercise a controlling influence over the will, conduct, and interest of another or where, *from a similar relationship of mutual confidence,* the law requires the utmost good faith, such as the relationship between partners, principal and agent, etc.

Ga. Code Ann. § 23-2-58 (emphasis supplied). Simply placing "great trust and confidence" in another will not create a confidential relationship. *Walsh v. Campbell,* 130 Ga. App. 194, 202 S.E.2d 657, 662 (Ga. Ct. App. 1973). *See also in re Tri-State Crematory Litig.,* 215 F.R.D. 660, 683 (N.D.Ga. Mar. 17, 2003); *Newitt,* 607 S.E.2d at

196 ("In the majority of business dealings, opposite parties have trust and confidence in each other's integrity, but there is no confidential relationship by this alone."); *Bowen*, 241 Ga. App. at 208 (a person who is "a close personal, confidential, and business adviser" is not a fiduciary). Instead, the fiduciary must be "so situated as to exercise a controlling influence over" the plaintiff. *Bowen*, 241 Ga. App. at 208 (citation omitted). *See also Tigner v. Shearson-Lehman Hutton, Inc.*, 201 Ga. App. 713, 715, 411 S.E.2d 800 (Ct. App. Ga. 1991) (finding a confidential relationship where a broker exercised a "controlling influence" over an account holder due to the latter's mental disabilities). In Georgia, a broker only becomes a "full-fledged fiduciary" of his client where the client has entrusted the broker with control over a discretionary trading account. *Prudential Bache Secur., Inc. v. Pitman*, 1991 U.S. Dist. LEXIS 10056, No. 1:89 Civ. 85 (JTC), 1991 WL 160039, *4 (N.D.Ga. Apr. 4, 1991); *Glisson*, 532 S.E.2d at 449 (Ga. Ct. App. 2000) ("with respect to a nondiscretionary account . . . the broker owes . . . the duty to transact business only after receiving prior authorization from the client and the duty not to misrepresent any fact material to the transaction.")

Holmes contends that Georgia law allows clients with nondiscretionary accounts to assert a claim for a breach of fiduciary duty, at least where the relationship is one of "mutual confidence." Business dealings are generally accompanied by trust and confidence, but that is insufficient under Georgia law to create a fiduciary relationship. *Newitt*, 607 S.E.2d at, 196 (Ct. App. Ga.

2004). Holmes' claim for breach of a fiduciary duty fails as a matter of law.

5. Georgia Securities Statute

The Citigroup Defendants move to dismiss Holmes' claim based on a violation of the Georgia Securities Act of 1973 because Holmes has not identified the provision of the statute on which he relies, as required by the March 2006 Opinion. The March 2006 Opinion required Holmes to identify "the specific provision" of the statute on which his suit was based. March 2006 Opinion, 2006 U.S. Dist. LEXIS 12471, [WL] at *3.

Holmes has pleaded a violation of "Title 10 Chapter 5 Section 12" and demands judgment pursuant to "Section 14" of the statute. *Section 12* alone contains twenty-three different prohibitions, as well as the single section which creates all substantive violations under the Georgia Blue Sky law. His pleading tracks provisions of the statute regulating offers of securities, the activities of investment advisors, securities dealers, and broker-dealers.

Holmes has not pleaded a violation of a specific section of the Georgia securities statute and has thereby obstructed any analysis of whether his pleading states a claim. His request for an additional opportunity to amend is denied. He was specifically warned that he would be given no further opportunity to amend. The defendants have already briefed three motions to dismiss in this litigation. They will not be put to the burden of a further round of briefing.

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6. Breach of Contract

The Citigroup Defendants move to dismiss the breach of contract claim for its failure to identify the provisions of the contract on which it is based, as required by the March 2006 Opinion. Holmes alleges in his breach of contract claim that he entered into customer agreements that required that all transactions "shall be subject to any applicable constitution, rules, regulations, customs and usages of the exchange or market and its clearinghouse...." The customer agreements also provided that Smith Barney could make customer loans and margin loans. Holmes asserts that Smith Barney promoted such loans and "improperly advanced substantial funds" to Holmes pursuant to the customer agreements and loan documents. The loans were "not suitable" for Holmes "in that they induced [him] to borrow money based on inflated stock prices and exaggerated and inappropriate loan amounts." Holmes concludes that Smith Barney denied him "the benefit of [the] bargain" in the customer agreements, violated its internal guidelines and regulations, allowed excessive, unauthorized margin loans based on inflated stock values, and breached duties of good faith and fair dealing.

Holmes has attached eighteen pages of account documents to his complaint. The first is a new account statement in which Holmes estimated his annual income at $ 600,000, and his net worth as $ 25 million. He identified his investment objectives as growth, and risk tolerance as aggressive and allowing for speculation. He

indicated that he had previously invested in options and was aware of the risks associated with options. In other attached documents, Holmes shared his tax identification number, authorized automatic funds transfers, guaranteed the account to which Smith Barney extended credit, and represented that he was authorized to represent his account.

Holmes contends in his opposition to the motion to dismiss the breach of contract claim that he is seeking to enforce "the 'guts' and 'substance'" of the customer agreements, which impose the duty on the broker to comply with law, and which imply a duty of good faith and fair dealing. In particular, he explains that this claim rests on his assertion that Smith Barney improperly advanced margin loans that were not suitable for Holmes and were based on a stock price that was inflated by the defendants' fraudulent misrepresentations and omissions. He contends in his opposition that Smith Barney, instead of acting "as a true 'broker/dealer,'" sold the stock in a series of involuntary transactions to protect itself instead of Holmes.

To the extent that Holmes is contending that Smith Barney violated any law or regulation, then he was obligated to identify the law and bring a claim pursuant to it, assuming it created a private right of action. To the extent that he is attempting to plead a breach of the duty of good faith and fair dealing, then under New York law, which he admits applies to this claim, he is required to plead as well a viable claim for breach of contract. Without an adequate pleading of a breach of a

term of contract, plaintiffs may not plead a breach of the implied duty of good faith and fair dealing. *Ari & Co., Inc. v. Regent Int'l Corp.*, 273 F. Supp. 2d 518, 523-24 (S.D.N.Y. Jul. 24, 2003); *EBC I, Inc. v. Goldman Sachs & Sachs & Co.*, 5 N.Y.3d 11, 22, 832 N.E.2d 26, 799 N.Y.S.2d 170 (N.Y. 2005); *Aventine Inv. Mgmt, Inc. v. Canadian Imperial Bank of Commerce*, 265 A.D.2d 513, 697 N.Y.S.2d 128 (App. Div. 1999).

Although Holmes argues that his claim rests on Smith Barney's breach of duties in connection with his margin account, he has not identified any contractual provision concerning his margin account that was breached, either in permitting Holmes to establish a margin account or in liquidating his investment accounts to meet margin calls. Because Holmes has not identified a specific contractual provision governing his relationship with Smith Barney that was allegedly breached by the defendant, this claim must be dismissed as well.

In sum, Holmes has failed to plead any violation of statutory or common law against either defendant. Holmes' initial iterations of his complaint relied solely on assertions that he had been injured when he held his stock instead of selling it, on reliance on the defendants' statements on June 25, 1999. Although he had not requested an opportunity to amend, the Court granted him a single opportunity to state claims based on purchases of WorldCom stock after June 25, 1999. It is now clear why Holmes did not begin by pleading claims based on such purchases. All of his WorldCom holdings

were sold, involuntarily, by the Fall of 2000, that is, long before any disclosure of any accounting fraud at WorldCom or any disclosure of wrongdoing by the defendants that could be alleged to have contributed to the decline in the price of WorldCom securities. He has therefore been unable to plead not just holder claims but also claims based on his purchases of WorldCom securities.

Conclusion

The motion to dismiss Holmes' third amended complaint is granted. The motion to enlarge is granted in part. The motion for remand is denied. The Clerk of Court shall close the case.

SO ORDERED:

Dated: New York, New York
October 13, 2006

DENISE COTE
United States District Judge

APPENDIX E — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT SOUTHERN DISTRICT OF NEW YORK DATED MARCH 24, 2006

MASTER FILE
02 Civ. 3288 (DLC)

No. 04 Civ. 8308

IN RE WORLDCOM, INC., SECURITIES MASTER FILE LITIGATION;

This Document Relates to:

WILLIAM K. HOLMES, HOLMES CAPITAL, LLC, AND BREW DOG, LLC, BIMINI STAR, LLC, and EBH INVESTMENTS CO., LLC,

Plaintiffs,

-v-

JACK B. GRUBMAN, and CITIGROUP GLOBAL MARKETS INC. F/K/A SMITH BARNEY & CO., INC.

Defendants.

MEMORANDUM OPINION AND ORDER

Appendix E

DENISE COTE, District Judge:

In connection with the fourth tranche of motions to dismiss filed in the WorldCom *Securities Litigation*, defendants Jack B. Grubman ("Grubman") and Citigroup Global Market Inc. F/k/a Smith Barney & Co., Inc. ("Citigroup") move to dismiss in its entirety the action filed by William K. Holmes and entities which he controls. The Holmes plaintiffs seek recovery under Georgia's securities statute and Georgia common law for their decision to hold WorldCom securities based on the defendants' failure to reveal a conflict of interest which distorted their investment advice. For the following reasons, the defendants' motion is granted with leave to amend.

Background

The relevant history of the WorldCom *Securities Litigation* is described in *inter alia Moxley v. CitiGroup Global Markets, Inc. (In re Worldcom Secs. Litig.)*, 2006 U.S. Dist. LEXIS 11679, 02 Civ. 3288, 04 Civ. 0232, slip op. (S.D.N.Y. Mar. 22, 2006); *In re WorldCom, Inc. Sec. Litig.*, 388 F. Supp. 2d. 319 (S.D.N.Y. 2005). Each of these Opinions is incorporated by reference.

On June 23, 2003, approximately a year after WorldCom's announcement of its fraud rocked financial markets, the plaintiffs filed this action in the United States Bankruptcy Court for the Middle District of Georgia, the court adjudicating Holmes' bankruptcy. The case was transferred to this Court and consolidated

for pre-trial purposes with the *Securities Litigation*. The plaintiffs moved for permission to file a second amended complaint ("Complaint") dated December 2, 2004.[1] Their request was granted by Order dated December 22, 2004, and it is to that pleading that this motion is addressed.

The Complaint alleges that on June 25, 1999, a Citigroup stockbroker convinced Holmes, by referring to Grubman's June 25 research report concerning WorldCom[2], not to sell the 2.1 million shares of WorldCom stock owned by Holmes and the entities that he controlled. Grubman was Citigroup's premier telecommunications analyst. At that time, the stock was trading in excess of $ 92 per share. Relying on that advice, Holmes withdrew his order to sell WorldCom stock and continued to hold those shares into late 2000, when the shares were sold involuntarily to meet margin calls. Holmes asserts losses approaching $ 200 million.

The Complaint describes purchases of shares from 1986 through 1990, long before any alleged fraud is alleged to have occurred. It also refers to purchases in 1999, including perhaps a purchase of an unidentified number of shares after June 25, 1999.

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1. Plaintiffs' motion was unopposed.

2. While the Complaint refers only vaguely to the research reports concerning WorldCom to which the stockbroker referred on June 25, 1999, it does list in a later section of the Complaint a June 25, 1999 research report authored by Grubman in which he recommends buying WorldCom stock.

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The Complaint asserts that Grubman and the stockbroker failed to disclose that Grubman and Citigroup had a conflict of interest that infected their investment advice concerning WorldCom. Drawing liberally from allegations contained in the class action complaint filed in the WorldCom *Securities Litigation*, the Complaint describes an accounting fraud at WorldCom and Grubman's close relationship with WorldCom executives. It asserts that Citigroup wanted WorldCom investment banking business and to obtain that business fooled the public into believing that WorldCom was a prudent investment. Most of the Complaint concerns activities occurring and investment advice given long after the June 25, 1999 conversation between Holmes and the stockbroker. [3]

The parties dispute the extent to which the Complaint is seeking damages for anything other than Holmes' decision to hold WorldCom securities. Most of the Complaint refers to Holmes decision to hold and not sell the WorldCom stock. The fraud claim is explicitly premised on that theory, as is every other claim but the claim pleaded under Georgia's securities statute. The securities statute claim pleads that the plaintiffs suffered injuries as a result of their purchase of WorldCom stock after June 25, 1999.

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3. It should be noted that in the WorldCom class action, the class period began on April 29, 1999, and the 1999 financial statements were the first financial statements filed by WorldCom that were alleged to be fraudulent.

Appendix E

Discussion

A complaint must contain "a short and plain statement of the claim showing that the pleader is entitled to relief." Rule 8(a)(2), Fed. R. Civ. P. The purpose of this requirement is to give fair notice of a claim and the grounds upon which it rests so that the opposing party may identify the nature of the case, respond to the complaint, and prepare for trial. *Swierkiewicz v. Sorema, N.A.*, 534 U.S. 506, 512, 122 S. Ct. 992, 152 L. Ed. 2d 1 (2002). *Rule 8* is fashioned in the interest of fair and reasonable notice, not technicality, and therefore is "not meant to impose a great burden upon a plaintiff." *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 125 S. Ct. 1627, 1634, 161 L. Ed. 2d 577 (2005). "The complaint thus need not set out in detail the facts upon which the claim is based." *Twombly v. Bell Atlantic Corp.*, 425 F.3d 99, 107 (2d Cir. 2005) (citation omitted). If it is clear, however, that "no relief could be granted under any sets of facts that could be proved consistent with the allegations," the claim should be dismissed. *Swierkiewicz*, 534 U.S. at 514. In construing the complaint, the court must "accept all factual allegations in the complaint as true and draw inferences from those allegations in the light most favorable to the plaintiff." *Jaghory v. New York State Dep't of Educ.*, 131 F.3d 326, 329 (2d Cir. 1997).

"The Rules do establish more demanding pleading requirements for certain kinds of claims." *Twombly*, 425 F.3d at 107. These claims, including fraud, must "be stated with particularity." Rule 9(b), Fed. R. Civ. P. To

comply with the requirements of Rule 9(b), an allegation of fraud must specify: "(1) those statements the plaintiff thinks were fraudulent, (2) the speaker, (3) where and when they were made, and (4) why plaintiff believes the statements to be fraudulent." *Koehler v. Bank of Bermuda (New York) Ltd.*, 209 F.3d 130, 136 (2d Cir. 2000).

The Complaint pleads six causes of action. They are fraud, breach of fiduciary duty, negligent misrepresentation, negligence, a violation of Georgia Blue Sky laws, and breach of contract.

For reasons explained in two Opinions issued in the *Securities Litigation*, Holmes' tort claims under Georgia law must be dismissed to the extent that they assert damages based on the plaintiffs' decision to hold their WorldCom securities instead of selling those securities. *See In re WorldCom, Inc. Sec. Litig.*, 2006 U.S. Dist. LEXIS 11679, 02 Civ. 3288, 04 Civ. 0232, slip op. (Mar. 22, 2006); *Weinstein v. Ebbers (In re WorldCom, Inc. Sec. Litig.)*, 336 F. Supp. 2d 310 (S.D.N.Y. 2004). Given this ruling, it is unnecessary to address the other arguments raised by the defendants in their motion to dismiss these claims.

The plaintiffs acknowledge that a "holder" claim is not actionable under Georgia's securities statute, but assert that they bring that claim solely in connection with their purchase of additional WorldCom securities after June 25, 1999. Despite the defendants' complaint in their moving papers that the pleading does not

identify under which provision of the statute the plaintiffs are proceeding, the plaintiffs still do not identify the provision in their opposition to this motion.

The breach of contract claim asserts liability premised on facts directly at odds with those asserted in the Complaint. It seeks damages because the stockbroker failed to execute a sell order;[4] the Complaint asserts that Holmes withdrew his sell order because he was convinced to do so by the broker's bullish recommendations concerning WorldCom. *See Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085, 1092 (2d Cir 1995) (In the context of a motion to dismiss, "general, conclusory allegations need not be credited ... when they are belied by more specific allegations of the complaint."). The breach of contract claim suffers from other infirmities as well. The plaintiffs do not identify any provision or provisions of a contract that were breached by the defendants.[5] Instead, they refer to an implied duty of good faith and fair dealing. Without an adequate pleading of a breach of a term of a contract, plaintiffs may not plead a breach of the implied duty of good faith and fair dealing. *See Stuart Enters. Int'l, Inc. v. Peykan, Inc.*, 252 Ga. App. 231, 555 S.E.2d 881, 884

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4. The defendants point out that the plaintiffs ratified any failure to sell securities when they did not complain after their next month's account statements showed that the WorldCom stock remained in their portfolio. That affirmative defense is not a ground for dismissal of a complaint.

5. The plaintiffs do not oppose the motion by Grubman to dismiss the breach of contract claim pleaded against him.

(Ga. Ct. App. 2001); *see also Alan's of Atlanta, Inc. v. Minolta Corp.*, 903 F.2d 1414, 1429 (11th Cir. 1990); *Interland, Inc. v. Bunting*, 2005 U.S. Dist. LEXIS 36112, No. 1:04-CV-444-ODE, 2005 WL 2414990, at *2 (N.D.Ga. Mar. 31, 2005); *HLD Enters. v. Michelin N. Am., Inc.*, 2004 U.S. Dist. LEXIS 18958, No. Civ. A.1:03 CV 2558 T., 2004 WL 2095739, at *3 (N.D.Ga. June 29, 2004).

The plaintiffs do not request an opportunity to amend their pleading. Nonetheless, because it appears that plaintiffs may be able to cure some of the deficiencies in their pleading, they will be permitted to file a third amended complaint. The amended complaint may not add new defendants or new causes of action. That pleading must identify with specificity any purchases of WorldCom stock after June 25, 1999, on which plaintiffs intend to rely in pressing any of their claims. To the extent they wish to pursue a claim under Georgia's securities statute, they must identify the specific provision they seek to enforce. To the extent they believe they can file a breach of contract claim that is consistent with the factual assertions in their pleading, they must identify the provision of the contract that was breached. They should address to the extent that they were able to do so the other deficiencies in the Complaint to which the defendants refer in their motion papers since they will be given no further opportunity to amend their pleading to cure those deficiencies. The plaintiffs will not be permitted to replead any tort claim seeking recovery on the ground that the plaintiffs held their WorldCom securities based on the defendants' conduct or advice.

Appendix E

Conclusion

The breach of contract claim against Grubman is dismissed with prejudice. The remaining claims are dismissed without prejudice to repleading in a third amended complaint filed by April 21, 2006.

SO ORDERED:

Dated: New York, New York
March 24, 2006

DENISE COTE
United States District Judge